Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 15 | Issue 2 Article 3

5-18-2021

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ABSTRACT

When institutional investors hire proxy advisors to prepare reports on matters up for vote at public company shareholder meetings, are they interested primarily in acquiring a bottom-line recommendation on how to vote, on which they can then blindly rely? Or in acquiring information that will help them make their own voting decisions? Supporters of controversial reforms introduced by the Securities and Exchange Commission (SEC) in 2019 and 2020 gravitate toward the former position, arguing that reform is needed to discourage undue reliance on proxy advisor recommendations. Opponents gravitate toward the latter position, arguing that additional regulation generally is unnecessary given that institutional investors already review their proxy advisors' work product and make their own voting decisions.

This article argues that neither of these positions presents a full picture of proxy advisors' role in shareholder voting, and puts forward a more nuanced account that better reflects existing empirical evidence: institutional investors tend to use proxy advisors first and foremost as issue spotters, helping them distinguish (i) controversial matters that require a review of the proxy advisor's analysis and potentially other information sources from(ii) non-controversial matters where they can vote in line with the proxy advisor's recommendation without undertaking further review. On this account, proxy advisors do influence shareholder voting, but this influence derives primarily from their ability to direct institutional investors' attention away from some proposals and toward others, rather than from institutional investors' following their recommendations in lockstep.

This account casts one common criticism of proxy advisors' standards—that they reflect a one-size-fits-all approach to corporate governance that results in recommendations that do not reflect each public company's unique circumstances—in a new light that exposes potential problems unaddressed by the SEC's reforms. At the same time, it casts doubt on the usefulness of many of the reforms introduced by the SEC, which appear to be predicated on the flawed assumption that blind reliance on proxy advisor recommendations is a serious problem.

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INTRODUCTION

When institutional investors hire proxy advisors to prepare reports on matters up for vote at public company shareholder meetings,[1] are they interested primarily in acquiring a bottom-line recommendation on how to vote, on which they can then blindly rely? Or are they more interested in acquiring a digestible summary of relevant background information that will help them make their own voting decisions?

Proponents of heightened proxy advisor regulation—like the controversial reforms introduced by the Securities and Exchange Commission (SEC) in 2019 and 2020[2]—gravitate toward the former position. For example, the U.S. Chamber of Commerce told Congress that institutional investors "frequently follow [proxy advisors'] recommendations automatically,"[3] and then-SEC Commissioner Daniel Gallagher has expressed concern that institutional investors are "engaging in rote reliance on proxy advisory firm recommendations."[4] According to this account, proxy advisors—particularly their market leader, Institutional Shareholder Services (ISS)—act as "de facto standard setters" exercising effective control of public companies' corporate governance despite having no economic stake in them.[5] This mismatch, the account continues, necessitates new rulemaking that discourages institutional investors from blindly relying on proxy advisor recommendations.[6]

Opponents of increased proxy advisor regulation gravitate toward the latter position, with the Council of Institutional Investors stating that institutional investors typically use proxy advisor research "solely as a supplement to their own evaluation of agenda items."[7] According to this

1. A proxy advisor might be hired by the institutional investor directly, or indirectly through an agent of the institutional investor. For example, a mutual fund will hire an investment adviser to manage its assets, including by exercising voting rights attaching to these assets, and the investment adviser will hire a proxy advisor to advise it on how best to exercise these voting rights.

2. *See infra* notes 66–69 and accompanying text.

3. Statement of the U.S. Chamber of Commerce on Examining the Market Power and Impact of Proxy Advisory Firms at 8 (June 5, 2013), https://docs.house.gov/meetings/BA/BA16/2013 0605/100958/HHRG-113-BA16-Wstate-PittH-20130605.pdf [https://perma.cc/NZN2-RD3J] [hereinafter U.S. Chamber of Commerce].

4. Daniel M. Gallagher, Comm'r, SEC, Remarks at Soc'y of Corp. Sec'ys. & Governance Prof'ls, Seattle, WA (July 11, 2013), https://www.sec.gov/news/speech/spch071113dmghtm [https: //perma.cc/VD5Q-DAUM].

5. Letter from Tom Quaadman, Executive Vice President, Ctr. for Capital Mkts. Competitiveness, to Vanessa A. Countryman, Sec'y, SEC at 1 (Jan. 31, 2020), https://www.sec.gov /comments/s7-22-19/s72219-6730872-207435.pdf [https://perma.cc/2Y82-AHDW]; U.S. Chamber of Commerce, *supra* note 3, at 8.

6. Timothy M. Doyle, *The Realities of Robo-Voting*, AM. COUNCIL FOR CAP. FORMATION 1, 10 (Nov. 2018) https://accfcorpgov.org/wp-content/uploads/ACCF-RoboVoting-Report_11_8_ FINAL.pdf [https://perma.cc/5BEU-X57W].

7. Letter via Email from Glenn Davis, Senior Research Assoc., Council of Institutional Inv'rs, to Elizabeth M. Murphy, Sec'y, SEC, at 6 (Oct. 14, 2010), https://www.sec.gov/comments/s7-14-10/s71410-80.pdf [https://perma.cc/UXU9-2EE4] [hereinafter CII Letter].

account, additional regulation of these "research providers"[8] is at best unnecessary given that institutional investors already review their proxy advisors' work product and make their own voting decisions. And at worst, it could impair the quality of shareholder oversight of public companies' management by making proxy advisor research more costly or difficult to obtain and use.[9]

Neither of these narratives seems to present a full picture of proxy advisors' role in shareholder voting. Judging from empirical research looking at the relationships between proxy advisor recommendations and shareholder voting, the difference between the average levels of shareholder support received by proposals endorsed by ISS and those opposed by ISS is too small—and varies too greatly depending on the type of proposal up for vote—to be consistent with the notion that all, or even most, institutional investors blindly rely on ISS's recommendations. And while a minority of institutional investors likely do blindly rely on ISS recommendations, assertions that this minority could be large enough to materially influence voting outcomes appear overblown. Proponents of this weakened version of the blind reliance narrative focus on institutions' assets under management (AUM) as a measure of voting influence at public companies, even though AUM includes holdings of fixed income and other non-equity asset classes (which do not carry voting rights) and private equity (equity investments in companies that are not publicly traded and, accordingly, are not covered by proxy advisors). When one focuses on these investors' collective holdings of U.S. public equities—which appear to amount to well under 2% of U.S. public market capitalization, based on a review of these investors' public disclosures—it becomes difficult to see how these holdings could materially influence voting outcomes.[10]

Turning to the narrative that institutional investors use proxy advisors merely as research providers—that is, aggregators of information these investors use to make their own voting decisions—surveys of institutional investors suggest that it is implausible that these investors apply equal scrutiny to every proposal that comes up for a shareholder vote.[11] These investors cite limited resources and the compressed time frame in which most U.S. shareholder meetings occur as serious constraints on their ability to make informed voting decisions.[12] This evidence suggests investors likely are taking shortcuts to make voting decisions.

8. Letter from Kenneth A. Bertsch, Exec. Dir., Council of Institutional Inv'rs, *et al*., to the Hon. Jay Clayton, Chairman, SEC, *et al*., at 2 (Oct. 15, 2019), https://www.sec.gov/comments/4-725/4725-6308155-193468.pdf [https://perma.cc/KC4D-ZBSC].

9. *Id*.

10. *Infra* Part II.B.

11. *Infra* Part II.C.

12. *Id*.

More nuanced accounts of proxy advisors' role in shareholder voting have received little attention,[13] and their implications for proxy advisor regulation even less.[14] This article aims to remedy these gaps by expanding on these accounts and exploring implications for reform. These implications should be relevant to any review of the SEC's reforms under the Biden Administration,[15] as well as the Administration's review of the related (and similarly controversial)[16] late 2020 rulemaking by the Department of Labor (DOL) on proxy voting by pension and other fiduciaries that are subject to the Employee Retirement Income Security Act of 1974 (ERISA).[17]

This article argues that institutional investors tend to use proxy advisors as issue spotters that help them distinguish controversial matters from non-controversial ones. When a proxy advisor's recommendation aligns with that of management, this signals that the vote is non-controversial and that the investor can rely on the advisor's recommendation without reviewing the proxy advisor's research or undertaking further analysis. In these circumstances, the investor takes a shortcut to reach a quick, inexpensive voting decision, and its behavior aligns with what the blind reliance narrative would predict. When a proxy advisor's recommendation opposes

13. For examples of these accounts, on which this article aims to elaborate, *see* Stephen Choi, Jill Fisch & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35, 65 (2013) [hereinafter Choi, Fisch & Kahan, *Who Calls the Shots?*] ("ISS's recommendations are influential because they focus shareholder attention, but not because shareholders follow those recommendations blindly"); Yonca Ertimur, Fabrizio Ferri & David Oesch, *Understanding Uncontested Director Elections*, 64 MGMT. SCI. 3400, 3402 (2018).

14. Rather, partisans on both sides of the debate have tended to cast empirical evidence on proxy advisor influence as supporting their side of the debate. *See, e.g.*, DOYLE, *supra* note 6, at 6; Letter from Kevin Cameron, Exec. Chair, & Nichol Garzon-Mitchell, Senior Vice President & Gen. Counsel, Glass, Lewis & Co., LLC, to Vanessa A. Countryman, Sec'y, SEC, at 29 (Feb. 3, 2020), https://www.sec.gov/comments/s7-22-19/s72219-6745349-207938.pdf [https://perma.cc/ND9K-KH2D] [hereinafter Glass Lewis Letter].

15. *See* John C. Coffee, Jr., *Biden and the SEC: Some Possible Agendas*, The CLS Blue Sky Blog (Dec. 2, 2020), https://clsbluesky.law.columbia.edu/2020/12/02/biden-and-the-sec-some-possible-agendas/ [https://perma.cc/5KJZ-ET2W] (predicting that a review of the SEC's proxy advisor reforms will be an area of focus under the Biden Administration).

16. *See, e.g.*, Robert A.G. Monks & Nell Minow, ValueEdge Advisors, *Proxy Voting by ERISA Fiduciaries*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 22, 2020), https://corpgov.law.harvard.edu/2020/10/22/proxy-voting-by-erisa-fiduciaries/ [https://perma.cc/UB4Z-PLFK]; Letter from James C. Allen, Head, & Karina Karakulova, Sr. Manager, Capital Mkts. Pol'y – Americas, CFA Inst., to Office of Regulations and Interpretations, Employee Benefits Security Admin., Dept. of Labor, at 2 (Oct. 5, 2020), https://www.cfainstitute.org/-/media/documents/comment-letter/2020-2024/20201005.ashx [https://perma.cc/5ZB8-JXVY]; *DOL Issues Final Proxy Voting Rule,* GROOM L. GRP. (Dec. 22, 2020), https://www.groom.com/resources/dol-issues-final-proxy-voting-rule [https://perma.cc/9AV2-NRG4].

17. Press Release, U.S. Dep't of Lab., US Department of Labor Releases Statement on Enforcement of its Final Rules on ESG Investments, Proxy Voting by Employee Benefit Plans (Mar. 10, 2021), https://www.dol.gov/newsroom/releases/ebsa/ebsa20210310 [https://perma.cc/3YNP-L7Y6] [hereinafter DOL Press Release]; Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 55,219 (proposed Sept. 4, 2020) [hereinafter DOL Proposed Rules]; *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, 85 Fed. Reg. 81,658 (Dec. 16, 2020) [hereinafter DOL Final Rules]. This rulemaking is discussed briefly in *infra* Part I.D.

management's recommendation, this signals that the vote is controversial and that the investor should examine the research presented in the proxy advisor's report, as well as other relevant information, to reach its own voting decision. In these circumstances, the investor's behavior aligns with what the research provider narrative would predict. On this account, proxy advisors do influence shareholder voting, but this influence derives primarily from their ability to direct institutional investors' attention away from some proposals and toward others, not from institutional investors' following proxy advisors' recommendations in lockstep. This account is consistent with an assumption that investors will tend to conserve the scarce resources they have to spend on making voting decisions for those votes that are most in need of independent analysis.

Adopting this account has at least three significant implications for proxy advisor regulation. First, it turns on its head a frequent criticism of proxy advisors' standards—reflected in the SEC's reforms—that their "one-size-fits-all" approach to corporate governance fails to account for the circumstances of individual companies and investors' diverse objectives.[18] Critics say this tends to result in too many negative recommendations (*i.e.*, recommendations to vote against the recommendations made by company management).[19] One-size-fits-all standards that err on the side of recommending against management will not lead to perfect recommendations on how to vote, but they can serve to weed out the easy cases—where the obvious answer is to vote with management—so that investors can focus their attention on the closer cases that require company-specific analysis, carried out in light of the investor's objectives. Rather than demonstrating the need for the types of reforms introduced by the SEC, these standards can be viewed as reflecting institutional investors' prudent use of proxy advisors as issue spotters. Proxy advisors' voting standards run into trouble only if they result in too *few* negative recommendations. Despite evidence suggesting this problem exists, potentially in part due to efforts by public company managers to game or otherwise evade these standards,[20] the SEC appears to have overlooked it in developing its package of reforms. This risk could be mitigated with guidance encouraging institutional investors to review records of their past votes to identify potential weaknesses in their proxy advisor's voting standards and work with the proxy advisor to resolve them.[21]

18. *See, e.g.*, CTR. FOR CAPITAL MKTS. COMPETITIVENESS & NASDAQ, PROXY SEASON 2018: EXAMINING DEVELOPMENTS & LOOKING FORWARD 3 (2018), https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/10/ProxySeasonSurvey_v3_Digital.pdf [https://perma.cc/6YNH-FJ6R].

19. *Id*.

20. *See infra* Part IV.B.

21. Technically, such SEC guidance would apply only to investment advisers. However, since such guidance would be grounded in investment advisers' duty to exercise voting rights prudently,

Second, this account points toward a more focused regulatory approach to the presentation and delivery of proxy advisor recommendations and related communications than that adopted by the SEC. Reforms should focus on helping institutional investors access new signals about the quality of proxy advisors' recommendations of which they would not otherwise have been aware, instead of merely reminding them of obvious risks—such as potential inaccuracies and conflicts of interest—that most investors already address by, among other things, scrutinizing recommendations on controversial matters. The SEC's overbroad approach appears to flow from the flawed assumption that institutional investors will blindly rely on proxy advisor recommendations unless they are presented with unambiguous signals that the value of these recommendations ought to be discounted.

Third, this account suggests that, instead of promulgating guidance that could be viewed as effectively prescribing what steps all institutional investors ought to take before casting votes, the SEC should focus its attention on the small minority of institutional investors that appear to vote in lockstep with proxy advisor recommendations. The SEC could reiterate that investment advisers can agree with their clients not to exercise voting rights to the extent they believe the costs of doing so likely will exceed the benefits and add that in assessing these costs investment advisers should consider the cost of independently reviewing proxy advisor recommendations on controversial matters.

Part I of this article provides background on proxy advisors and the evolution of their regulation in the United States. Part II critiques the blind reliance and research provider accounts of proxy advisor influence in light of empirical evidence. Part III introduces the argument that institutional investors use proxy advisors as issue spotters, describing the contexts in which proxy advisors are most likely to play this role and the limited circumstances where they seem unlikely to play this role. Part IV describes the policy implications that flow from this account of proxy advisor influence.

I. A BRIEF HISTORY OF PROXY ADVISORS AND THEIR REGULATION

Proxy advisors provide two core services to institutional investors: they analyze and make voting recommendations on matters presented for shareholder vote in a proxy statement (on the basis of guidelines developed by the proxy advisor or customized by the client), and they provide administrative machinery to facilitate investors' casting and tracking their

a duty that is shared by other institutional investors, other institutional investors likely would look to such guidance in determining how to comply with this duty. *See infra* Part II.A.

votes.[22] Some proxy advisors also offer consulting services to public companies (also referred to as "issuers") on corporate governance or executive compensation matters, typically aimed at gauging or increasing the likelihood that management proposals on these matters will receive shareholder approval.[23] ISS is the world's leading proxy advisor, with the largest client base and broadest coverage of public companies.[24] Glass Lewis follows ISS with respect to client base and depth of company coverage.[25]

Public company management teams seek shareholder approval on a wide variety of matters at annual shareholder meetings. First and foremost, they need shareholders to elect management's slate of director nominees to the board.[26] Even if the slate is running unopposed, shareholders can express their displeasure with one or more of the nominees by voting to "Withhold" their vote for the nominee(s).[27] In addition, public companies generally are required to seek shareholder approval of newly adopted equity compensation plans,[28] and to hold non-binding shareholder votes to approve executive compensation (referred to as "say-on-pay" votes) every year, every two years, or every three years[29] (as determined by shareholders every six years in a "say-on-frequency" vote).[30] Shareholders also are entitled to bring non-binding proposals up for vote at each annual meeting.[31] These shareholder proposals address matters as diverse as executive compensation, corporate governance, climate change, and labor rights. Activist investors also may use shareholder meetings to initiate a contest for corporate control by running a rival slate of director nominees against the slate of nominees aligned with management (a "proxy contest").

22. *See, e.g.*, Institutional S'holder Servs., *Proxy Voting Services*, https://www.issgovernance.com/solutions/proxy-voting-services/ [https://perma.cc/VTY8-43MK]; Institutional S'holder Servs., *Custom Policy and Research*, https://www.issgovernance.com/solutions/governance-advisory-services/custom-policy-research/ [https://perma.cc/Z4PQ-W6TB].

23. *See generally* ISS Corp. Sols., https://www.isscorporatesolutions.com [https://perma.cc/W4FD-NTXZ].

24. *See* Asaf Eckstein & Sharon Hannes, *A Long/Short Incentive Scheme for Proxy Advisory Firms*, 53 WAKE FOREST L. REV. 787, 793 (2018); U.S. GOV'T ACCOUNTABILITY OFF., CORPORATE SHAREHOLDER MEETINGS: PROXY ADVISORY FIRMS' ROLE IN VOTING AND CORPORATE GOVERNANCE PRACTICES 6–7 (2016), https://www.gao.gov/assets/690/681050.pdf [https://perma.cc/P7KJ-Z66S].

25. Eckstein & Hannes, *supra* note 24, at 793; U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 24, at 6–7.

26. *See, e.g.*, DEL. CODE ANN., tit. 8, § 211(b) (2009).

27. If the company has adopted a majority voting policy, a director that receives a majority of "Withhold" votes generally must offer their resignation.

28. NYSE AMERICAN COMPANY GUIDE § 711; NASDAQ RULE 5635(c).

29. 17 C.F.R. § 240.14a-21(a) (2011).

30. 17 C.F.R. § 240.14a-21(b) (2011).

31. 17 C.F.R. § 240.14a-8 (2011).

A. THE AVON LETTER AND THE RISE OF PROXY ADVISORS

Historically, shareholder votes were not controversial affairs. Shareholder custom was to vote in accordance with the recommendations of management—if a shareholder was dissatisfied with management, they had an easy remedy available in selling their shares.[32] This custom of investor deference to management eroded significantly over the 1980s, with the rise of mutual funds and other institutional investors that had the resources to scrutinize and reach independent views on matters up for vote, and that accordingly began using the shareholder voting process to express these views.[33] These institutional investors increasingly turned to proxy advisors and other consultants and organizations to support these activities.[34]

But the rise of proxy advisors was not a result of market changes alone. It was in large part a product of regulation.[35] The DOL's 1988 "Avon Letter" is widely viewed as having provided the opening salvo. The letter opined that "decision[s] as to how proxies should be voted" by the investment managers of pension and health plans (overseen by the DOL pursuant to ERISA) "are fiduciary acts of plan asset management."[36] Accordingly, in the DOL's view, managers must exercise these voting rights in accordance with their fiduciary duties: "prudently, solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries."[37] ISS, founded three years earlier, promised to help managers vote proxies prudently and cost-effectively with research and recommendations that managers otherwise might have been expected to produce independently.[38]

32. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 261 (1962).

33. Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 447–50 (1991).

34. *Id*. at 450.

35. Regulation also may have prevented alternative channels for producing the services proxy advisors now provide, such as institutional investor trade groups, from arising. *See* Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. REV. 1459, 1496–1500 (2019) (suggesting that less stringent rules regarding shareholder coordination in the United Kingdom may explain why institutional investor trade groups play a dominant role in setting corporate governance norms and why, as a result, proxy advisors appear less influential than in the United States).

36. Letter from Allan Lebowitz, Dep. Ass't Sec'y of the Pension Welfare Benefits Admin. at the U.S. Dep't of Lab., to Helmuth Fandl, Chairman of the Ret. Bd., Avon Products, Inc., 1988 WL 897696 at *2 (Feb. 23, 1988).

37. *Id*. at *3 n.4. The Avon Letter was followed by the DOL's Interpretive Bulletin No. 94-2 (codified at 29 C.F.R. § 2509.94-2), which among other things restated the views set out in the Avon Letter. This guidance was updated in 2008 and 2016. Interpretive Bulletin Relating to Exercise of Shareholder Rights, 73 Fed. Reg. 61,731 (Oct. 17, 2008); Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95,879 (Dec. 29, 2016). The DOL revisited the issue with new rules promulgated in December 2020. *Infra* Part I.D.

38. One of ISS's co-founders, Robert A.G. Monks, laid much of the foundation for the Avon Letter in his prior role as a senior official in the DOL. R. FRANKLIN BALOTTI, JESSE A.

In a 2003 rulemaking (the Proxy Voting Rules),[39] the SEC confirmed its view that investment advisers that manage the assets of mutual funds and other investment companies are subject to similar obligations:

The federal securities laws do not specifically address how an adviser must exercise its proxy voting authority for its clients. Under the Advisers Act, however, an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting.[40]

The Proxy Voting Rules fleshed out this obligation with new Rule 206(4)-6 under the Investment Advisers Act of 1940 (the Advisers Act)[41] requiring investment advisers to adopt written policies and procedures reasonably designed to ensure they vote proxies in the best interests of clients.[42] The Proxy Voting Rules' adopting release also suggested that retaining a proxy advisor is not only permissible, but desirable as a means of demonstrating that an investment adviser's vote is not driven by conflicts of interest: "an adviser could demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party."[43]

In addition to encouraging demand for proxy advisory services, regulation operated on the supply side, removing legal barriers to the provision of proxy advisory services. One such barrier was uncertainty over whether proxy advisors' reports are subject to the proxy solicitation rules promulgated under the Securities Exchange Act of 1934 (the Exchange Act)[44]—in particular, Rule 14a-3's requirement that any solicitation be accompanied by a proxy statement.[45] In a 1992 rulemaking,[46] the SEC created a new exemption from these rules and clarified the scope of another. Proxy advisors that provide only research services to their clients could rely

FINKELSTEIN, GREGORY P. WILLIAMS & ALAN MILLER, MEETINGS OF STOCKHOLDERS § 12.5.1 (3d ed. 2021).

39. Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585 (Feb. 7, 2003).

40. *Id*. at 6586.

41. 15 U.S.C. §§ 80b-1 to 80b-21.

42. 17 C.F.R. § 275.206(4)-6(a) (2003). The Proxy Voting Rules also require investment advisers to disclose information to their clients about those policies and procedures, and how these clients can find out how the adviser has voted their proxies. Proxy Voting by Investment Advisers, *supra* note 39, at 6585. The rulemaking also introduced new Rule 204-2 under the Advisers Act, requiring advisers to retain records of, among other things, votes they cast on behalf of clients and any documents advisers prepared that were material to or memorialized the basis for their voting decision. *Id*. at 6588. A companion rulemaking required investment companies to file annual voting records with the SEC on Form N-PX, and to provide disclosure about how they vote proxies relating to portfolio securities they hold. Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, 6569 (Feb. 7, 2003).

43. Proxy Voting by Investment Advisers, *supra* note 39, at 6588.

44. 15 U.S.C. §§ 78a–78qq.

45. 17 C.F.R. § 240.14a-3(a) (1974).

46. Regulation of Communications Among Shareholders, 57 Fed. Reg. 48,276 (Oct. 22, 1992).

on new Rule 14a-2(b)(1), which exempts most communications with shareholders from the proxy solicitation requirements so long as the person making the communication does not seek authority to act as proxy for these shareholders.[47] Proxy advisors that offer clients a platform for casting votes in tandem with research services could rely on revised Rule 14a-2(b)(3), which exempts voting advice furnished by a person that "renders financial advice in the ordinary course of business," subject to compliance with certain disclosure and other rules relating to possible conflicts of interest.[48]

A second relevant development was SEC guidance effectively permitting proxy advisors to generate additional revenue by advising issuers on how to align their corporate governance practices with their voting standards. In two no-action letters delivered in 2004, the SEC staff (the Staff) clarified expectations about how investment advisers should respond to potential conflicts of interest between proxy advisors and their issuer clients so as to comply with their obligation under the Proxy Voting Rules to exercise voting rights in the best interests of their clients. In a letter delivered to a representative of the proxy advisor Egan-Jones (the Egan-Jones Letter),[49] the Staff stated that investment advisers must assure themselves that a proxy advisor can make recommendations "in an impartial manner and in the best interests of the adviser's clients" before following the proxy advisor's recommendations.[50] One means of assuring themselves of a proxy advisor's independence, the Staff added, would be to require the proxy advisor to disclose "any relevant facts" concerning its relationship with an issuer, "such as the amount of the compensation that the firm has received or will receive" from that issuer.[51] In a subsequent letter delivered to a representative of ISS (the ISS Letter),[52] the Staff opined that advisers could, alternatively, gain this assurance by undertaking "a thorough review of the proxy voting firm's conflict procedures and the effectiveness of their implementation."[53] The ISS Letter is significant because it indicates that an investment adviser can rely on a proxy advisor's recommendations without inquiring into whether proxy advisor provided services to the issuer that is the subject of these recommendations, so long as the proxy advisor provides assurances that it has implemented procedures sufficient to address any conflicts of interest that

47. 17 C.F.R. § 240.14a-2(b)(1) (2010).

48. 17 C.F.R. § 240.14a-2(b)(3) (2010). While Rule 14a-2(b)(3) preceded the 1992 rulemaking, the SEC staff had taken the position that proxy advisors do not provide "financial advice" to their clients (due to their advising only on the exercise of voting rights). Institutional S'holder Servs., Inc., SEC No-Action Letter, 1991 WL 179448 (Dec. 15, 1988). The 1992 rulemaking reversed this position. Regulation of Communications Among Shareholders, *supra* note 46, at 48,282 n.41.

49. Egan-Jones Proxy Servs., SEC No-Action Letter, 2004 WL 1201240 (May 27, 2004).

50. *Id*. at *3.

51. *Id*. at *4.

52. Institutional S'holder Servs., Inc., SEC No-Action Letter, 2004 WL 2093360 (Sept. 15, 2004).

53. *Id*. at *2.

could arise from such a relationship (*e.g.*, separating staff providing proxy voting recommendations to advisers from staff providing governance advice to issuers).[54] While this SEC guidance is addressed only to investment advisers, other institutional investors are likely to regard this guidance as reflective of their respective fiduciary obligations to their clients.[55]

B. THE SEC COURSE CORRECTS WITH STAFF LEGAL BULLETIN NO. 20

Over the decade following the ISS and Egan-Jones Letters, market and regulatory developments further increased proxy advisors' importance in corporate democracy. First, corporate governance trends, such as majority voting policies for board elections and "say-on-pay" votes approving executive compensation, along with rising shareholder activism, increased the stakes of shareholder votes.[56] Second, revisions to NYSE Rule 452 adopted in 2009 limiting brokers' ability to vote uninstructed shares in uncontested director elections removed a key constituency on which corporate management typically could rely for support—brokers tended to vote their clients' shares in accordance with management recommendations without seeking outside advice (in the absence of specific voting instructions from their clients).[57] Third, the continued growth of institutional investors meant an ever greater percentage of votes cast at shareholder meetings would be cast by clients of proxy advisors.[58]

Critics offered at least three reasons why institutional investors' apparent reliance on proxy advisors might be misplaced: (i) conflicts of interest arising from proxy advisors' providing services to both investors and issuers may lead them to provide biased voting advice that favors their issuer clients; (ii) their methodologies for generating voting recommendations reflect a dubious one-size-fits-all approach to governance that fails to recognize that good governance may mean different things for different companies in different contexts; and (iii) proxy advisors' recommendations may be based on mistaken or otherwise flawed understandings of relevant information.[59]

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54. *Id*.

55. *See* Roberta S. Karmel, *Should a Duty to the Corporation be Imposed on Institutional Shareholders?*, 60 BUS. LAW. 1, 2 (2004) ("Institutional shareholders are not investing their own capital, but the capital of others to whom they owe fiduciary duties.").

56. Michael Cappucci, *The Proxy War Against Proxy Advisors*, 16 N.Y.U. J.L. & BUS. 579, 614–15 (2020). A majority voting policy generally requires director nominees to resign if they fail to receive a majority of votes "For" their election (i.e., as a result of shareholders voting to "Withhold" support for the nominee), even if the election was uncontested.

57. *Id*. at 615.

58. *Id*. at 582–83.

59. *See, e.g.*, CTR. ON EXEC. COMP., A CALL FOR CHANGE IN THE PROXY ADVISORY INDUSTRY STATUS QUO: THE CASE FOR GREATER ACCOUNTABILITY AND OVERSIGHT 42–61, WALL ST. J. (2011),
http://online.wsj.com/public/resources/documents/ProxyAdvisoryWhitePaper02072011.pdf

Staff Legal Bulletin No. 20 (SLB 20),[60] issued in 2014, may be viewed as a response to these concerns. SLB 20 provided additional guidance on investment advisers' due diligence obligations with respect to their relationships with proxy advisors. The Staff opined that an adviser's obligations to its clients require it to conduct diligence on a proxy advisor to ensure the proxy advisor has "the capacity and competency to adequately analyze proxy issues," both prior to hiring the proxy advisor and on an ongoing basis.[61] This diligence review should cover "the adequacy and quality of the proxy advisory firm's staffing and personnel" as well as its policies and procedures for ensuring the accuracy and independence of its recommendations.[62] The Staff also suggested that investment advisers should review their voting policies and procedures at least annually, and that this review could include "periodically sampling proxy votes to review whether they complied with the investment adviser's proxy voting policy and procedures."[63] In short, SLB 20 made clear the Staff's view that purchasing and relying on proxy advisor recommendations is not enough to satisfy investment advisers' obligations under the Proxy Voting Rules; investment advisers must also bear the ongoing, additional cost of monitoring their proxy advisors. The Staff added that if an investment adviser believes undertaking these costs is not in its clients' best interests, then the adviser can agree with its clients that it will not vote some or all of the shares it holds on behalf of its clients.[64]

C. POST-2016 SEC REFORMS

Following the 2016 U.S. presidential election and subsequent nomination and confirmation of Jay Clayton as SEC Chairman, the SEC announced a series of measures rolling back previous guidance and proposing to substitute new, more burdensome proxy advisor regulation and guidance. This began with the withdrawal of the ISS and Egan-Jones Letters in September 2018,[65] and was followed by the introduction of two new interpretive releases in August 2019,[66] and proposed rules (the Proposed Rules) published in

[https://perma.cc/SR7Z-K6UR]; Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 101, 120–33 (2007).

60. SEC Staff Legal Bulletin No. 20 (IM/CF) (June 30, 2014), https://www.sec.gov/interps/legal/cfslb20.htm [https://perma.cc/J4FJ-5NN9] [hereinafter SLB 20].

61. *Id*. at Question 3.

62. *Id*.

63. *Id*. at Question 1.

64. *Id*. at Question 2.

65. Public Statement, SEC, Statement Regarding Staff Proxy Advisory Letters (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters [https://perma.cc/9RRL-2FU7].

66. Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, 84 Fed. Reg. 47,416 (Sept. 10, 2019) [hereinafter Proxy Advisor Guidance (2019)]; Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 Fed. Reg. 47,420 (Sept. 10, 2019) [hereinafter Investment Adviser Guidance (2019)].

November 2019,[67] with corresponding final rules (the Final Rules) published, together with an additional interpretive release,[68] in July 2020.[69]

Together, these actions may be seen as targeting three broad concerns: (i) institutional investors do not have the information necessary to evaluate whether a proxy advisor's conflicts of interest may be affecting the objectivity of its recommendations, (ii) institutional investors that hire proxy advisors to provide both research and voting services (the latter of which often entails "pre-populating" an investor's electronic proxy forms to reflect the proxy advisor's voting recommendations) are not quality checking the pre-populated forms before casting their votes, and (iii) institutional investors are unduly relying on proxy advisor recommendations that are inaccurate or otherwise flawed.

The withdrawal of the Egan-Jones and ISS Letters removed the comfort these letters had provided that investment advisers could rely on proxy advisors' recommendations without inquiring into conflicts of interest specific to these recommendations. The August 2019 interpretive releases went further by suggesting that proxy advisors should provide, and investment advisers should request, information about a proxy advisor's material conflicts of interest regardless of whether the proxy advisor has measures in place to prevent these conflicts from affecting its objectivity.[70] This view was codified in the Final Rules.[71]

One of the SEC's August 2019 interpretive releases suggested that, as part of their obligation to prudently exercise their voting rights, investment advisers could sample votes that have been pre-populated by a proxy advisor to ensure compliance with the investment adviser's policies and procedures before these votes are cast.[72] More generally, the SEC added that investment advisers could subject proxy contests and other matters relating to corporate control to a "higher degree of analysis" than other proposals, and adopt

Interpretive releases, though issued by the Commission (rather than the Staff), are a form of guidance, and accordingly are not legally binding or subject to notice-and-comment.

67. Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 66,518 (proposed Dec. 4, 2019) (to be codified at 17 C.F.R. pt. 240) [hereinafter Proposed Rules].

68. Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 85 Fed. Reg. 55,155 (Sept. 3, 2020) [hereinafter Supplemental Investment Adviser Guidance (2020)].

69. Exemptions from the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 55,082 (Sept. 3, 2020) (to be codified at 17 C.F.R. pt. 240) [hereinafter Final Rules]. Proxy advisors will be expected to comply with the Final Rules beginning December 1, 2021. *Id.* at 55,122.

70. Investment Adviser Guidance (2019), *supra* note 66, at 47,425; Proxy Advisor Guidance (2019), *supra* note 66, at 47,419.

71. 17 C.F.R. §§ 240.14a-2(b)(9)(i)(A), 240.14a-9, Note (e) (2020). The SEC's basis for directly regulating proxy advice is that proxy advice constitutes a solicitation of a proxy under Rule 14a-1, and as a result must (i) fall within the Rule 14a-2(b)(1) or (b)(3) exemptions from the general requirement that such solicitations be accompanied by a proxy statement, and (ii) comply with the Rule 14a-9 antifraud rules. *See* Proxy Advisor Guidance (2019), *supra* note 66, at 47,417; 17 C.F.R. § 240.14a-1(l)(1)(iii)(A) (2020).

72. Investment Adviser Guidance (2019), *supra* note 66, at 47,424.

policies and procedures "that provide for consideration of additional information that may become available" about proposals after they receive their proxy advisor's recommendation, such as supplemental proxy filings by the issuer in response to the recommendation.[73] The SEC's July 2020 interpretive release expanded on this latter point, stating that investment advisers should consider having policies and procedures in place to ensure that any material information filed by an issuer in response to a proxy advisor recommendation factors into their decision-making process before they vote, provided that information is filed "sufficiently in advance of the submission deadline."[74]

The Proposed Rules also conditioned proxy advisors' reliance on the Rule 14a-2(b)(1) and (b)(3) exemptions on their implementation of a series of processes that generally would give issuers (i) an opportunity to review and comment on a draft version of the proxy advisor's report, (ii) early access to the final report before it is sent to the proxy advisor's clients, and (iii) the ability to require the proxy advisor to include in its report a hyperlink to the issuer's response to that report, if any.[75] The Final Rules walked these proposals back somewhat, requiring instead that proxy advisors adopt policies and procedures reasonably designed to (i) ensure issuers receive copies of their reports no later than the time these reports are disseminated to clients, and (ii) provide clients with a mechanism through which they can be made aware of the issuer's response in a timely manner before the relevant shareholder meeting.[76] For example, if the issuer notifies the proxy advisor that it intends to file such a response as additional soliciting materials, the proxy advisor can pass this notice along to clients, and then pass along a hyperlink to the response when available.[77] Finally, the Final Rules implemented the proposal made in the Proposed Rules to amend the Note to Rule 14a-9 to state that a proxy advisor's failure to disclose to its clients material information about its methodology and conflicts of interest could render its advice materially misleading.[78]

73. *Id*.

74. Supplemental Investment Adviser Guidance (2020), *supra* note 68, at 55,156.

75. Proposed Rules, *supra* note 67, at 66,530–34, 66,538.

76. Final Rules, *supra* note 69, at 55,108–13; 17 C.F.R. § 240.14a-2(b)(9)(ii) (2020). The proxy advisor can condition its providing copies of such reports on the issuer filing its proxy statement at least 40 days before the meeting date and agreeing that it will use any report provided to it only for internal purposes or in connection with the solicitation. 17 C.F.R. § 240.14a-2(b)(9)(iii) (2020). These requirements do not apply to voting recommendations developed on the basis of a "custom" voting policy adopted by the investor. 17 C.F.R. § 240.14a-2(b)(9)(v) (2020). What constitutes a "custom" voting policy may prove to be a matter for debate, given that custom voting policies are anecdotally believed to be, for the most part, highly similar to proxy advisors' standard form policies. Adam O. Emmerich, Wachtell, Lipton, Rosen & Katz, *Initial Perspectives and Implications of SEC Proxy Advisory Reform*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 8, 2020), https://corpgov.law.harvard.edu/2020/08/08/initial-perspectives-and-implications-of-sec-proxy-advisory-reform/ [https://perma.cc/73AT-Y24X].

77. 17 C.F.R. § 240.14a-2(b)(9)(iv) (2020).

78. Final Rules, *supra* note 69, at 55,118–19; 17 C.F.R. § 240.14a-9, Note (e) (2020).

Taken together, these measures appear to reflect a belief that institutional investors, or at least some substantial minority of institutional investors, are blindly relying on proxy advisors' recommendations and that regulatory action is needed to stop them from continuing to do so. On this view, additional disclosures regarding conflicts of interest are necessary because institutional investors cannot be relied on to demand sufficient information to judge the objectivity of proxy advisors' recommendations on their own, additional guidance regarding pre-populated votes is necessary to stop institutional investors from allowing their votes to be automatically cast in ways that do not reflect their true preferences and do not reflect all information material to their voting decisions, and mechanisms requiring proxy advisors to communicate issuers' responses to their reports to their institutional investor clients are necessary because these investors cannot be relied upon to seek out this information on their own.

D. Postscript: The DOL's December 2020 Rulemaking

While this article focuses on the SEC's 2019 and 2020 reforms, a brief mention of the DOL's subsequent rulemaking on proxy voting by ERISA fiduciaries is warranted. Citing concerns about a "misunderstanding that exists on the part of some stakeholders that ERISA fiduciaries are required to vote all proxies,"[79] and "that fiduciaries may be over-relying on proxy advisory firms as a result of such confusion, by implementing advisory firms' voting recommendations without attention to whether the firms' policies are consistent with the economic interests of the plan,"[80] particularly when it comes to shareholder proposals reflecting "environmental, social, or public policy agendas,"[81] the DOL, led by then-Secretary Eugene Scalia, introduced new requirements governing the exercise of voting rights by ERISA fiduciaries. The DOL's final rules restrict fiduciaries' discretion to consider environmental, social, and governance factors when exercising voting rights and require them to, among other things, "[c]onsider any costs involved" in voting and "[e]valuate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights" (*e.g.*, management's response to a negative proxy advisor recommendation).[82] Fiduciaries that choose to retain a proxy advisor are required to exercise "prudence" in selecting a proxy advisor and monitoring that proxy advisor's activities.[83] Fiduciaries are barred from adopting a practice of following their proxy advisor's recommendations without determining that the advisor's voting standards are consistent with the proxy voting principles listed in the final

79. DOL Final Rules, *supra* note 17, at 81,660.
80. DOL Final Rules, *supra* note 17, at 81,662.
81. DOL Proposed Rules, *supra* note 17, at 55,222.
82. 29 C.F.R. § 2550.404a-1(e)(2)(ii) (2020).
83. 29 C.F.R. §§ 2550.404a-1(e)(2)(ii)(F), 2550.404a-1(e)(2)(iii) (2020). The rules do not prescribe what specific steps a fiduciary should take to monitor these activities.

rules.[84] The rules also provide fiduciaries with safe harbors allowing them to adopt a policy of casting votes only on particular types of high-stakes proposals (*e.g.*, proposals affecting corporate control), or refraining from voting when the plan's holdings in the relevant company fall below a given portion of the plan's assets, or both, without giving rise to doubt over whether these practices satisfy their fiduciary responsibilities under ERISA.[85] Firms will have until 2022 to begin complying with the new rules.[86]

The rushed timing of the rulemaking—proposals were published on August 31 with a 30-day window for submitting comments, and were finalized in mid-December—leaves the impression that the DOL was racing to finalize these rules before the expiration of President Trump's term. Under President Biden, the DOL announced in March 2021 that it would be revisiting the new rules, and would not be enforcing them in the interim,[87] opening the way for a more fulsome consideration of these rules' possible effects on institutional investors' exercise of their voting rights.

II. EVALUATING THE MAINSTREAM NARRATIVES OF PROXY ADVISOR INFLUENCE

Returning to the SEC's package of reforms, if either of the following two versions of the blind reliance narrative are true, the reforms would appear warranted. The first is a strong version of the narrative, which claims that it is typical for institutional investors to blindly rely on proxy advisor recommendations. The second is a weak version of the narrative, which suggests that even if only a minority of institutional investors blindly follow proxy advisor recommendations, this minority is large enough to be material to the outcome of a shareholder vote. Proponents of both versions of this narrative cite empirical evidence to support their claims. For example, the U.S. Chamber of Commerce cites the significant swings in investor opinion that tend to accompany a negative recommendation from a proxy advisor (*e.g.*, a recommendation to vote against a proposal submitted by management) as "an obvious reflection of the fact that ISS' and Glass Lewis' institutional clients frequently follow these firms' recommendations automatically."[88] The American Council for Capital Formation (ACCF), while shying away from making general claims about institutional investors' reliance on ISS recommendations, emphasizes the potential influence exercised by a minority of investors that appear to vote in full alignment with ISS recommendations: "firms representing trillions of [dollars of] assets

84. 29 C.F.R. § 2550.404a-1(e)(2)(iv) (2020).
85. 29 C.F.R. § 2550.404a-1(e)(3) (2020).
86. 29 C.F.R. § 2550.404a-1(g)(3) (2020).
87. DOL Press Release, *supra* note 17.
88. U.S. Chamber of Commerce, *supra* note 3, at 8.

under management are voting their shares almost exactly in line with proxy advisors' recommendations."[89]

Opponents of additional proxy advisor regulation paint a markedly different picture of proxy advisors' role in the voting process. They characterize proxy advisors' role as that of research provider—far from dictating the outcomes of shareholder votes, they merely collect and organize information that institutional investors use to make voting decisions.[90] According to this account, voting decisions are made by institutional investors, not proxy advisors, and accordingly claims that proxy advisor recommendations effectively dictate the outcomes of shareholder votes are mistaken.

This Part critiques each of these narratives in light of empirical evidence. With respect to the strong version of the blind reliance narrative, it notes that the vote swings empirical researchers have associated with ISS recommendations fall well short of even a conservative measure of ISS's total client base, suggesting that a significant bloc of ISS's clients can be expected, on any given vote, to break with ISS and vote with management when ISS and management issue opposing recommendations. This is not consistent with the strong version of the blind reliance narrative. With respect to the weak version of the blind reliance narrative, it accepts that a minority of institutional investors appear to blindly follow ISS recommendations, but takes issue with the notion that AUM provides an accurate measure of these investors' voting influence. It uses these investors' SEC filings on Form 13F and other disclosures to arrive at what should be a more accurate estimate of these investors' voting influence and concludes that these investors' holdings of U.S. public equities appear too small to have a material impact on the outcomes of shareholder votes at U.S. public companies. Finally, while it appears that the research provider narrative has at least some power in explaining how institutional investors use proxy advisors, it may not explain all, or even most, of the voting decisions investment advisers make. Surveys of institutional investors highlighting their limited resources for independently evaluating every voting decision they are required to make,[91] together with institutional investors' near-unanimous support for management proposals that are endorsed by ISS,[92] suggest that it is implausible that institutional investors apply independent scrutiny to every proposal that comes up for a shareholder vote.

89. Doyle, *supra* note 6, at 5–7.
90. *See, e.g.*, Glass Lewis Letter, *supra* note 14, at 29.
91. *Infra* Part II.C.
92. *Infra* Part II.C, Table 3.

A. THE STRONG VERSION OF THE BLIND RELIANCE NARRATIVE

If ISS's clients tend to blindly rely on its recommendations (regardless of the nature of the recommendation), then most of its clients will vote in favor of proposals that ISS supports, and vote against proposals that ISS opposes. As such, the difference between the average level of support received by ISS-supported proposals and ISS-opposed proposals should approximate the proportion of the vote controlled by ISS's client base. In theory, we could arrive at a rough measure of this figure by dividing the total public equity assets managed by ISS's clients by the global market capitalization of public equities. The challenge is that, while ISS disclosed that it had over 2,000 institutional investor clients as of 2020,[93] it has not published a recent estimate of the size of its clients' public equity investments. The U.S. Government Accountability Office, however, published an estimate of this amount in June 2007—$25.5 trillion—based on information provided by ISS.[94] This figure represents roughly 40–50% of the global market capitalization of public equities at the time, depending on whether one uses December 31, 2006, or December 31, 2007, as a reference point.[95]

This 40–50% range likely understates the potential impact of ISS's recommendations on shareholder voting, at a minimum for votes occurring in 2007 or later. First, proxy advisors' clients are institutional investors, which are significantly more likely to exercise their voting rights than other investors.[96] As such, their voting influence should be larger than reflected in their share of equity holdings. Second, ISS's client base appears to have, at a minimum, held flat since 2007, and more likely has expanded since this time. Over this period, it added approximately 300 new clients,[97] and it remains acknowledged as the clear market leader in the provision of proxy advice.[98] Because Glass Lewis, widely viewed as second to ISS in market share, does publish estimates of its own clients' public equity assets, it is possible to arrive at a floor for measuring the size of ISS's current client base. Glass Lewis's most recent estimate was over $35 trillion,[99] representing roughly

93. Cappucci, *supra* note 56, at 590.

94. U.S. GOV'T ACCOUNTABILITY OFF., CORPORATE SHAREHOLDER MEETINGS: ISSUES RELATING TO FIRMS THAT ADVISE INSTITUTIONAL INVESTORS ON PROXY VOTING 5 (2007), https://www.gao.gov/products/gao-07-765 [https://perma.cc/7A77-LDQL].

95. World Bank, *Market capitalization of listed domestic companies (current US$)*, https://data.worldbank.org/indicator/CM.MKT.LCAP.CD [https://perma.cc/K84Q-UJA9].

96. BROADRIDGE & PRICEWATERHOUSECOOPERS, PROXYPULSE: 2019 PROXY SEASON REVIEW 5 (2019), https://www.broadridge.com/_assets/pdf/broadridge-proxypulse-2019-review.pdf [https://perma.cc/7H82-HPC8].

97. *Compare* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 94, at 13 (estimating that ISS had approximately 1,700 clients as of 2007), *with* Cappucci, *supra* note 56, at 590 (citing ISS estimate that it had over 2,000 clients as of 2020).

98. *See, e.g.*, Eckstein & Hannes, *supra* note 24, at 793.

99. *Company Overview*, GLASS LEWIS, https://www.glasslewis.com/company-overview/ [https://perma.cc/8YWM-YK6K].

42% of global market capitalization as of the end of 2019,[100] falling within our 40–50% range. The DOL's 2020 rulemaking provides a measure of additional confidence that this range is a conservative one, as it claimed off-hand that ISS "controls approximately 60 percent of the market"—the DOL did not, however, describe how it arrived at this figure or how it chose to define "control" or "the market."[101]

There are two complicating factors, however. One is that some of ISS's clients have adopted custom proxy voting policies and rely on ISS to develop recommendations based on these policies rather than ISS's in-house policies. Thus, at least some of ISS's clients' divergence from general ISS recommendations may reflect clients' blind reliance on ISS's application of these custom policies rather than clients' independent review of ISS recommendations. Anecdotal evidence that these custom voting policies tend to diverge only in minor ways from proxy advisors' general guidelines,[102] however, provides a degree of comfort that clients with custom voting policies will not receive radically different sets of proxy advisor recommendations than their peers. A second complicating factor is that, assuming ISS's client base tends to grow over time, the 40–50% threshold applied here may overestimate ISS's potential influence in votes that occurred prior to 2007. This threshold may be of especially limited value for votes that occurred prior to the adoption of the Proxy Voting Rule in 2003 and the issuance of the ISS and Egan-Jones Letters in 2004, as these developments are regarded as pivotal in encouraging institutional investors to hire proxy advisors.[103]

With these cautions in mind, the table below introduces 11 studies looking at the impact proxy advisors' recommendations have on shareholder voting, segmented by the type of proposal forming the focus of each study. The table lists the types of proposals and time periods reviewed in each study and, to the extent described in the study, (i) the difference between the average level of shareholder support garnered by proposals receiving a favorable ISS recommendation and the average support garnered by

100. Jesse Pound, *Global stock markets gained $17 trillion in value in 2019*, CNBC (Dec. 24, 2019), https://www.cnbc.com/2019/12/24/global-stock-markets-gained-17-trillion-in-value-in-2019.html [https://perma.cc/BQ2C-W83L] (citing data from Deutsche Bank Research).

101. DOL Proposed Rule, *supra* note 17, at 55,222. For example, does "the market" mean all investors, or just institutional investors? Does it refer to the U.S. only, or the world? What does "control" mean? Simply that investors have hired ISS as their proxy advisor, or something more? The DOL's rule proposal did not offer a response to any of these questions.

102. Letter from Darla C. Stuckey, President & CEO, Soc. for Corp. Gov., to Vanessa A. Countryman, Sec'y, SEC, at 8 n. 8 (Feb. 3, 2020), https://www.sec.gov/comments/s7-22-19/s72219-6743687-207853.pdf [https://perma.cc/W2U5-2XBN] [hereinafter Society for Corporate Governance Letter]. *See also* Frank M. Placenti, Squire Patton Boggs, *Are Proxy Advisors really a Problem?* HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 7, 2018), https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-really-a-problem [https://perma.cc/X72W-N424].

103. *See, e.g.*, Eckstein & Hannes, *supra* note 24, at 795; Cappucci, *supra* note 56, at 587.

proposals receiving an unfavorable recommendation, and (ii) any correlations the study's authors found between ISS recommendations and level of support. Studies that examine more than one type of proposal are listed more than once. Reflecting the diminished relevance of the 40–50% threshold for votes occurring prior to 2007, and the likely significance of the 2003 Proxy Voting Rule and the 2004 Egan-Jones and ISS Letters for proxy advisors' growth, I have excluded from consideration studies that look exclusively at votes occurring prior to these regulatory developments.

Table 1: Studies Measuring ISS Influence on Voting Outcomes

Proposal Type	**Authors (Year)**	**Time Period**	**Possible Effects of Negative ISS Recommendation**	
			Difference in Average Support	**Correlation with Level of Support**
Uncontested directors' elections	Cai, Garner & Walkling (2009)[104]	2003–2005	-18.7%	-8.5% / -20.7%
	Choi, Fisch & Kahan (2010)[105]	2005–2006	-20.3%	-6.4% to -13.1%
	Ertimur, Ferri & Oesch (2018)[106]	2003–2010	-21.1%	-20.6% to -20.8%
	Copland, Larcker & Tayan (2018)[107]	2017	-18.3%	N/A
Say-on-pay	Thomas, Palmiter & Cotter (2012)[108]	2003–2010	-19%	N/A
	Malenko & Shen (2016)[109]	2010–2011	-24.3%	-25%

104. Jie Cai, Jacqueline L. Garner & Ralph A. Walkling, *Electing Directors*, 64 J. FIN. 2389, 2395, 2401, 2403, 2406–07 (2009). *See infra* text accompanying notes 121–122 for a description of the two regressions undertaken by the authors (and resulting correlation coefficients).

105. Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 885, 903, 907 (2010) [hereinafter Choi, Fisch & Kahan, *Myth or Reality?*].

106. Ertimur, Ferri & Oesch, *supra* note 13, at 3403–04.

107. JAMES R. COPLAND, DAVID F. LARCKER & BRIAN TAYAN, PROXY ADVISORY FIRMS: EMPIRICAL EVIDENCE AND THE CASE FOR REFORM 12 (2018), https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf [https://perma.cc/GTT5-3JYH].

108. Randall S. Thomas, Alan R. Palmiter & James F. Cotter, *Dodd-Frank's Say on Pay: Will it Lead to a Greater Role for Shareholders in Corporate Governance?*, 97 CORNELL L. REV. 1213, 1244 (2012). Figures reflect votes on management proposals only; results relating to shareholder proposals are discussed in Part III.B, *infra*.

109. Nadya Malenko & Yao Shen, *The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design*, 29 REV. FIN. STUD. 3394, 3399, 3404 (2016).

	Cotter, Palmiter & Thomas (2013)[110]	2011	-28.3%	-26.7%
	Ertimur, Ferri & Oesch (2013)[111]	2011	-26.8%	-24.8%
	Larcker, McCall & Ormazabal (2014)[112]	2011	N/A	-22%
	Fisch, Palia & Davidoff Solomon (2018)[113]	2011–2016	N/A	-30.8%
	Copland, Larcker & Tayan (2018)[114]	2017	-27.7%	N/A
Equity plans	Copland, Larcker & Tayan (2018)[115]	2017	-17.3%	N/A
Proxy contests	Brav, Jiang, Li & Pinnington (2019)[116]	2008–2015	-39.7%	N/A
	Copland, Larcker & Tayan (2018)[117]	2017	-73%	N/A

In all these studies except two, the difference in average support depending on whether ISS recommended for or against management fell short of our 40–50% threshold, ranging from 17.3% to 28.3%. The two exceptions are the Brav, Jiang, Li & Pinnington study, which looks exclusively at voting by U.S. mutual funds (making the 40–50% threshold an inappropriately low benchmark given that most mutual funds would be expected to hire a proxy advisor),[118] and the portion of the Copland, Larcker & Tayan study looking at proxy contests, which should be regarded with little weight given how few proxy contests fell within the scope of their study

110. James F. Cotter, Alan R. Palmiter & Randall S. Thomas, *The First Year of 'Say on Pay' Under Dodd-Frank: An Empirical Analysis and Look Forward*, 81 GEO. WASH. L. REV. 967, 989, 991 (2013).

111. Yonca Ertimur, Fabrizio Ferri & David Oesch, *Shareholder Votes and Proxy Advisors: Evidence from Say on Pay*, 51 J. ACCT'G. RES. 951, 976 (2013).

112. David F. Larcker, Allan L. McCall & Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J. L. & ECON. 173, 185 (2013).

113. Jill Fisch, Darius Palia & Steven Davidoff Solomon, *Is Say on Pay All About Pay? The Impact of Firm Performance*, 8 HARV. BUS. L. REV. 101, 117 (2018).

114. Copland, Larcker & Tayan, *supra* note 107, at 12.

115. *Id*.

116. Alon Brav, Wei Jiang, Tao Li & James Pinnington, *Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests* 17 (European Corp. Governance Inst., Fin. Working Paper No. 601/2019, 2020), https://ssrn.com/abstract=3101473. The 39.7% figure reflects the difference in average support among mutual funds, not investors generally.

117. Copland, Larcker & Tayan, *supra* note 107, at 12.

118. Brav, Jiang, Li & Pinnington, *supra* note 116, at 1.

(37).[119] Setting these exceptions aside, it appears that a substantial portion of ISS's clients generally can be expected to break with ISS and side with management when ISS issues a negative voting recommendation. Perhaps more importantly, the vote swings observed in the event of a negative recommendation from ISS also seem to vary substantially depending on the nature of the proposal being voted on, with uncontested directors' elections showing vote swings that average between 18.3% and 21.1%, and say-on-pay votes showing vote swings averaging largely in the mid-to-high 20s. This suggests many institutional investors place different weights on ISS's recommendations in different circumstances, again inconsistent with the strong version of the blind reliance narrative.

Studies that aim to measure the correlation between ISS recommendations and voting outcomes—controlling for factors that might influence both ISS's recommendation and the subsequent shareholder vote, such as a firm's financial performance and various indicators of good corporate governance, or factors that might influence the vote regardless of ISS's recommendation, such as a recommendation from a different proxy advisor—cast further doubt on this version of the narrative. While their results vary widely, from 6.4% to 30.8%, they all fall short of our 40–50% threshold. What is more, at least one of these studies suggests that investors' likelihood of voting in line with an ISS recommendation depends in part on the rationale ISS offers for its recommendation, suggesting that investors pay attention not only to the direction but also to the reasoning behind ISS's recommendations when casting votes.[120]

The strength of the correlation one finds depends on the factors one uses as controls. For example, Cai, Garner & Walkling ran two separate sets of regressions: one focused on company-specific factors that might explain voting outcomes for a slate of management nominees in an uncontested directors' election, and the other focused on director-specific factors that might explain the vote share received by a specific nominee. They found that if ISS recommends "Withhold" in respect of 100% of the director nominees at a company in an uncontested directors' election, the average percentage of "For" votes received by these director nominees should fall by about 20.7 percentage points.[121] By contrast, if ISS recommends "Withhold" in respect of a specific director nominee, the percentage of "For" votes received by that nominee should be about 8.5 percentage points lower than that received by

119. Copland, Larcker & Tayan, *supra* note 107, at 12. Proxy contests (contested directors' elections) are rare, which is why other authors looking at voting patterns for proxy contests look at contests occurring over periods of several years. *See, e.g.*, Brav, Jiang, Li & Pinnington, *supra* note 107, at 1; Cindy R. Alexander, Mark A. Chen, Duane J. Seppi & Chester S. Spatt, *Interim News and the Role of Proxy Voting Advice*, 23 REV. FIN. STUD. 4419, 4421 (2010).

120. Ertimur, Ferri & Oesch, *supra* note 111, at 980–81.

121. Cai, Garner & Walking, *supra* note 104, at 2401 (holding constant the company-specific factors included in the regression).

other director nominees at the same company that received a "For" recommendation from ISS.[122]

Studies have taken varying approaches to the "omitted variable" problem that faces any regression model—that the model misses some outside factor that, in this context, would explain both ISS's recommendations and corresponding voting outcomes. Choi, Fisch & Kahan tried to address this problem in their study by taking the following steps. First, they controlled for a series of pre-identified company- and director-specific factors, finding that the marginal impact of a "Withhold" recommendation was 13.1 percentage points.[123] To control for omitted variables that could influence both voting outcomes and ISS recommendations, the authors distinguished between voting patterns of institutional investors (who typically have access to ISS recommendations) and retail investors (who typically do not).[124] Assuming retail investors do not have access to ISS recommendations, any change in their voting patterns associated with a "Withhold" recommendation must be attributable to other factors. After controlling for the influence of these unknown, outside factors, the authors arrived at a drop of 6.4 percentage points associated with institutional investors' reliance on a "Withhold" recommendation.[125]

Malenko & Shen, looking at say-on-pay votes occurring over 2010–2011, took a different approach. Over this period, ISS subjected a company's say-on-pay proposal to closer review if the company's one- and three-year total shareholder return fell below the median for that firm's industry.[126] The authors focused on firms falling close to this cut-off: assuming the distribution of companies falling just below and just above this cut-off is random, any difference in say-on-pay voting outcomes among these companies should be attributable to ISS rather than to company-specific factors.[127] The authors found that companies falling within a 10% band below the threshold were 20% more likely to receive an "Against" recommendation from ISS, and received 5% fewer "For" votes, than companies falling within a 10% band above the threshold.[128] Dividing 5% by 20%, the authors concluded that an "Against" recommendation from ISS can be expected to reduce the amount of "For" votes a say-on-pay plan receives by 25 percentage points.[129]

The studies described above, while tending to undermine the blind reliance narrative, suggest that ISS recommendations have at least some

122. *Id*. at 2407 (holding constant the other director nominee-specific factors in the regression).
123. Choi, Fisch & Kahan, *Myth or Reality?*, *supra* note 105, at 895.
124. The authors note that public disclosure of a proxy advisor recommendation is uncommon outside of a proxy contest. *Id*. at 901.
125. *Id*. at 903.
126. Malenko & Shen, *supra* note 109, at 3396.
127. *Id*.
128. *Id*. at 3404.
129. *Id*.

power to move investors' votes in ways that cannot be explained by other factors. Choi, Fisch & Kahan, even after their efforts to control both for factors they identified as relevant to shareholder voting and for unidentified factors implied from shifts in retail voting behavior, found that a negative ISS recommendation had a residual influence on voting outcomes.[130] Malenko & Shen's study focusing on seemingly indistinguishable firms lying on opposite sides of an ISS-drawn bright line suggests ISS's influence on voting outcomes might be especially important for borderline cases.[131] I will return to these findings in Part III.A.

B. THE WEAK VERSION OF THE BLIND RELIANCE NARRATIVE

Even if blind reliance on ISS recommendations is not the norm, it could reflect the practices of a minority of institutional investors that is sufficiently large to influence voting results in a material way. Materiality in this context means more than influencing whether a proposal is successful or unsuccessful. For example, even if a management proposal (*e.g.*, an uncontested director nomination or a say-on-pay proposal) succeeds, the level of support received may be low enough that management opts to make some form of concession (*e.g.*, by revising its compensation practices, or exploring a change in CEO) to respond to perceived shareholder discontent.[132]

Iliev & Lowry, examining voting patterns by 2,051 mutual funds over 2006–2010, found that over 25% of these funds voted in line with ISS recommendations over 99% of the time, suggesting that these funds had adopted a blanket policy of voting in line with ISS recommendations.[133] Iliev & Lowry also found, however, that these funds had characteristics that made them less likely to be able to materially impact voting outcomes than their peers: these funds tended to be smaller, invest smaller percentages of their net assets in any single issuer, and own smaller percentages of issuer equity than other funds.[134] As the authors observed, it likely is rational for a fund with these characteristics to underinvest in voting—such a fund's ability to influence voting outcomes is relatively low, and even if the fund's votes did

130. Choi, Fisch & Kahan, *Myth or Reality?*, *supra* note 105, at 903.

131. Malenko & Shen, *supra* note 109, at 3404.

132. *See, e.g.*, Cai, Garner & Walkling, *supra* note 104, at 2390–91; Ertimur, Ferri & Oesch, *supra* note 111, at 984–86.

133. Peter Iliev & Michelle Lowry, *Are Mutual Funds Active Voters?*, 28 REV. FIN. STUD. 446, 451–52, 454 (2015)*; see also* Stephen Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 324 (2008) (reporting results of a 2006 survey of U.S. pension funds, including that 20% of respondents reported delegating complete voting authority to ISS or another organization).

134. Iliev & Lowry, *supra* note 133, at 455.

affect voting outcomes, the benefit to the fund likely would be too small to have any real impact on the fund's returns.[135]

A 2013 study by Choi, Fisch & Kahan sought to estimate the influence of mutual funds that blindly rely on voting recommendations by looking at these funds' total assets.[136] Taking a sample of 60 mutual fund families, with equal representation from "large," "medium," and "small" fund families, the authors reviewed these fund families' votes on uncontested directors' elections at S&P 1500 companies over 2005–2006.[137] After separating these fund families into "clusters," those "funds that vote largely in lockstep with one another",[138] they found that "fund clusters that follow ISS with respect to more than 99% of all ISS recommendations accounted for a mere 3.04% of the sample assets."[139]

A November 2018 report by the ACCF that looked at voting patterns by mutual funds as well as other institutional investors uncovered findings that, at least at first glance, appear more troubling: 82 institutional investors, representing $1.37 trillion in AUM, voted in line with ISS recommendations on management and shareholder proposals at least 99% of the time over 2012–2018.[140] The 20 largest institutional investors falling into this group accounted for $1.2 trillion in AUM alone.[141] The report refers to these investors as "robo-voters," in light of their seemingly automatic reliance on ISS recommendations, and cites the magnitude of these investors' AUM as evidence of their potential influence over shareholder votes.[142] Others appear to have equated AUM with voting influence as well.[143]

AUM is not, however, a reliable measure of voting influence. A fund that invests primarily in fixed income securities (which carry no voting rights) or

135. *Id. See also* Larcker, McCall & Ormazabal, *supra* note 112, at 183–84; Ertimur, Ferri & Oesch, *supra* note 111, at 981. In addition, that any benefits arising from exercising voting rights would be shared by all investors, regardless of whether they exercise voting rights prudently, dampens all investors' incentives to invest in good governance.

136. Choi, Fisch & Kahan, *Who Calls the Shots?*, *supra* note 13.

137. *Id*. at 45–46.

138. *Id*. at 48.

139. *Id*. at 53.

140. Doyle, *supra* note 6, at 8. Voting information "was pulled from [ISS's Proxy Insight] platform as of October 13, 2018 and was filtered to include only those funds that had voted on more than 100 resolutions. ISS alignment data on the platform reflects all data available for each investor, which generally dates back as early as July 1, 2012 through the date it was pulled." *Id*. at 7 n.5. The "as of" date of the author's measure of AUM is unclear, and may be constrained by the currency of the database or other sources relied on. For example, the private equity firm Blackstone's total AUM is reported as $368 billion, but this figure was current only as of March 31, 2017, over a year before the study was published. *Compare id.* at 8, *with* BLACKSTONE, FIRST QUARTER 2017 EARNINGS MEDIA CALL 2 (Apr. 20, 2017), https://s23.q4cdn.com/714267708/files/doc_events/BLACKSTONE-Q1-2017-Media-Call-Transcript.pdf [https://perma.cc/7YKY-9KEV].

141. Doyle, *supra* note 6, at 8.

142. *Id*. at 11.

143. *See, e.g.*, Paul Rose, *Robovoting and Proxy Vote Disclosure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 25, 2019), https://corpgov.law.harvard.edu/2019/11/25/robovoting-and-proxy-vote-disclosure/ [https://perma.cc/J4VB-VWYU].

private equity (not publicly traded) may have substantial AUM but few votes at public company shareholder meetings. The identities of some of the top robo-voters listed in the ACCF report, including Blackstone (primarily known for investing in private equity) and the Virginia Retirement System and Los Angeles County Employees Retirement Association (both pension funds, which can be expected to invest most of their assets in fixed income securities because they need a stockpile of stable, liquid assets to maintain regular payments to retirees), leads one to expect that these entities' U.S. public equity holdings would represent only a small portion of their AUM.

Because the ACCF lists the 20 largest robo-voters identified in its research (ordered by AUM),[144] it is possible to gain a rough picture of these investors' possible impact on U.S. shareholder meetings by looking at their public filings. Most of these institutional investors file quarterly totals of their holdings of U.S. public equities and certain other securities with the SEC on Form 13F (available online via the SEC's Electronic Data Gathering and Retrieval system (EDGAR)), while some others disclose information about their assets in their annual reports. The table below draws from this data, which are presented as of December 31, 2017, unless noted otherwise.

Table 2: Holdings of Top 20 Institutional Investors that Vote in Line with ISS at least 99% of the Time[145]

Investor	AUM as stated by ACCF ($ millions)	Holdings reported on Form 13F (or other source as noted) ($ millions)
Blackstone Group	368,000	24,564
AQR Capital Management LLC	224,000	108,193
United Services Automobile Association	137,000	36,532
Arrowstreet Capital	69,952	42,189
Virginia Retirement System	67,804	8,467
Los Angeles County Employees Retirement Association[(a)]	56,000	8,198
Baring Asset Management / Barings LLC	40,000	7,689
Numeric Investors, LLC	39,800	15,086

144. Doyle, *supra* note 6, at 8.

145. Form 13F holdings include assets over which the manager shares investment discretion with another manager. Holdings reported on Form 13F are available on EDGAR. Holdings attributed to managers that do not file Form 13F were retrieved from the following sources: L.A. CNTY. EMPL RET. ASS'N, IT ALL ADDS UP: 2018 ANNUAL REPORT 88, 90 (2018), https://www.lacera.com/archives/archivesInvestments/annual_report_2018/cafr.pdf [https://perma.cc/TUB7-4ZG8]; ALAMEDA CNTY. EMPL. RET. ASS'N, BUILDING UP YOUR FUTURE: COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE YEAR ENDED DECEMBER 31, 2017 45 (2018), https://www.acera.org/sites/main/files/file-attachments/2018.06.29_2017_cafr_final.pdf [https://perma.cc/MQ73-U9PG]; PENSIONSKASSE SBB, GESCHÄFTSBERICHT 2017 29 (2018), https://spkr.ch/de/file_upload/9910d3e523e6b976b37c53319719c471.pdf [https://perma.cc/FA46-VKPL].

PanAgora Asset Management, Inc.	38,400	26,651
First Trust Portfolios Canada	28,000	28,000[(b)]
ProShare Advisors LLC	23,900	14,416
Kentucky Teachers' Retirement System	16,576	8,513
Stone Ridge Asset Management	16,285	1,516
Pensionskasse SBB[(a), (c)]	16,280	1,750
Euclid Advisors LLC[(d)]	13,500	-
Rafferty Asset Management, LLC	13,275	5,789
Driehaus Capital Management LLC	8,803	2,636
Alameda County Employees' Retirement Association[(a)]	6,966	1,475
DSM Capital Partners LLC	6,500	7,183
Weiss Multi-Strategy Advisers LLC	5,725	3,895
Total	**1,196,766**	**352,741**

a) Information drawn from annual report, as the entity does not file on Form 13F. For the Los Angeles County Employees Retirement Association, the figure presented is the average of the totals it reported as of June 30, 2017, and June 30, 2018 (it reports figures annually as of June 30, the end of its fiscal year).

b) The Canadian securities filings (available at www.sedar.com) of the funds managed by First Trust's Canadian portfolio manager (FT Portfolios Canada Co.) suggest this entity's AUM is far smaller than the figure obtained by the ACCF. It is possible that this figure includes some portion of the ETF assets managed by the entity's U.S. affiliate, First Trust Advisors L.P. Out of caution, the ACCF's AUM figure has been left in place.

c) As this entity does not separately disclose its holdings of U.S. public equities, its reported holdings of public equities in developed markets (outside Switzerland) are reflected in this table instead. Figure converted from Swiss francs to U.S. dollars using the exchange rate in effect as of December 31, 2017 (1 CHF = 1.0261 USD).

d) The entity discontinued filing on Form 13F. Its final Form 13F filing (for Q3 2016) disclosed U.S. public equity holdings of $0.

The $352.7 billion total reflected in the table above is less than one-third of the nearly $1.2 trillion total reached using the AUM figures published by the ACCF, and amounts to only 1.2% of U.S. public market capitalization as of year-end 2017.[146] In respect of the other robo-voters too small to be named in the ACCF report, if we were to adopt the extreme assumption that all of these robo-voters' AUM represented investments in U.S. public equities, this would only get us to a total of $528 billion, or approximately 1.7% of U.S.

146. *See supra* note 95.

public market capitalization—a percentage that seems unlikely to have a material influence on shareholder voting outcomes.

This figure comes with caveats. First, institutional investors' Form 13F filings frequently contain errors.[147] But because evidence suggests these errors are not biased in any particular direction,[148] it seems reasonable to expect that over- and understatements of investors' holdings would tend to cancel each other out. To the extent errors in investors' Form 13F disclosures result in an understatement of their equity holdings, a second problem with these disclosures likely counteract this result: the types of securities required to be disclosed on Form 13F extend beyond stock in U.S. public companies. Form 13F also requires disclosure of holdings of certain equity options and warrants, closed-end investment companies, and U.S.-listed stocks of non-U.S. issuers.[149] To the extent such holdings are reflected in the table above, this results in an overstatement of these investors' voting power. Some reassurance in this estimate is gained from it being intuitive that investors that blindly rely on ISS recommendations would tend to have little influence on voting outcomes—these investors would blindly rely on ISS recommendations precisely because they know their holdings are too insignificant for them to have any realistic probability of affecting the shareholder vote. If robo-voters were as influential as the proponents of the blind reliance narrative suggest, they presumably would have an incentive to cast informed votes instead of blindly relying on a proxy advisor.[150]

In summary, proponents of the weak version of the blind reliance narrative are right to note that a minority of institutional investors appear to be blindly relying on ISS recommendations, based on their voting behavior. But they are wrong to point to these investors' AUM as evidence that these investors could have a material influence on a shareholder vote. Many types of funds, including pension funds and funds that advertise themselves as having primary expertise in an asset class other than public equities, may have substantial AUM but relatively small public equity holdings. Form 13F filings and other disclosures of institutional investors presumed to be robo-voters illustrate the problems with conflating AUM and U.S. public equity holdings, and suggest that robo-voters are unlikely to be material to the outcomes of shareholder votes at U.S. public companies.

C. THE PROXY ADVISORS AS RESEARCH PROVIDERS NARRATIVE

The discussion in Parts II.A and II.B lends some support to the proxy advisors as research providers narrative. It drew from institutional investors'

147. Anne Anderson & Paul Brockman, *An Examination of 13F Filings*, 41 J. FIN. RES. 295, 299 (2018).
148. *Id*. at 322–23.
149. SEC, *Frequently Asked Questions About Form 13F* (Feb. 24, 2020), https://www.sec.gov/divisions/investment/13ffaq.htm [https://perma.cc/3L9G-SQM7].
150. *See supra* notes 133–139 and accompanying text.

voting patterns to suggest that most, though not all, institutional investors disagree with their proxy advisors on some matters. These voting patterns also suggest that institutional investors seem to take different views on different ISS recommendations, depending on the surrounding circumstances. However, there is reason to doubt that this narrative reflects institutional investors' behavior on all, or even most, votes.

First, surveys and other data indicate that smaller institutional investors face significant challenges exercising their voting rights, and that they rely heavily on proxy advisors' recommendations in exercising these rights. In one survey of U.S. pension funds, about half of respondents reported delegating full voting authority to a proxy advisor, to be exercised in accordance either with the proxy advisor's policies or custom policies set by the investor.[151] In neither case can the proxy advisor's role be cast as that of mere research provider. The investor does not leave itself discretion to make a different voting decision based on the information collected by the proxy advisor, or to receive additional information from the issuer or another party that might lead it to disagree with the proxy advisor's recommendation. A 2018 report by BlackRock stated that while some institutional investors "have their own in-house proxy voting and stewardship functions that use the research from proxy advisory firms as an input into their investment stewardship process, … others rely more heavily or even exclusively on the recommendations of proxy advisors for deciding how to vote."[152] The report added that "given the large number of votes that take place during proxy season each year, many investors rely heavily on the recommendations of proxy advisors to determine their votes, as they may not have the resources to individually analyze each proposal in detail."[153] The discussion on robo-voting in Part II.B is consistent with the notion that some institutional investors, albeit representing a small minority of U.S. public equity holdings, appear to vote in line with proxy advisor recommendations unquestioningly.

Second, and more importantly, there is reason to doubt that even mid-size and larger institutional investors would separately scrutinize every proposal that comes up for a vote. Exercising voting rights is far from a costless exercise, and one would expect institutional investors to try to minimize costs. Hiring a proxy advisor to play the role of research provider may go some of the way toward reducing the costs of voting, but even then, the task of making fully informed voting decisions may be overwhelming. To make a fully informed voting decision, an institutional investor presumably would need to review its proxy advisor's report, understand and

151. Choi & Fisch, *supra* note 133, at 324.

152. BARBARA NOVICK, MICHELLE EDKINS, TOM CLARK & ALEXIS ROSENBLUM, BLACKROCK, THE INVESTMENT STEWARDSHIP ECOSYSTEM 5–6 (2018), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf [https://perma.cc/DZQ2-A7NY].

153. *Id.*

evaluate the material assumptions and analyses underlying the report (*e.g.*, selection of compensation peer groups, calculation of financial and other metrics), and review background information in management's proxy statement as well as additional information from management and third parties that may be developed in response to the proxy advisor's report. The challenge of finding staff to undertake this work is compounded by U.S. public companies' tendency to schedule their shareholder meetings within the same four-month proxy season, such that institutional investors are required to make the vast majority of their annual voting decisions within a compressed timespan.[154] One reasonably would expect institutional investors to look for shortcuts.

While these shortcuts are not apparent when one focuses on institutional investors' responses to negative proxy advisor recommendations, shifting focus to positive proxy advisor recommendations offers some clues. Eight of the studies summarized in Table 1 report the average level of support a management proposal received when ISS issued a recommendation to vote for that proposal.

Table 3: Average Levels of Support for Management Proposals Endorsed by ISS[155]

Proposal Type	Authors (Year)	Time Period	Average Level of Support with Positive ISS Recommendation
Uncontested directors' elections	Cai, Garner & Walkling (2009)	2003–2005	96.2%
	Choi, Fisch & Kahan (2010)	2005–2006	96.4%
	Ertimur, Ferri & Oesch (2018)	2003–2010	96.4%
	Copland, Larcker & Tayan (2018)	2017	97.2%
Say-on-pay	Thomas, Palmiter & Cotter (2012)	2003–2010	92.4%
	Malenko & Shen (2016)	2010–2011	93.2%
	Cotter, Palmiter & Thomas (2013)	2011	92.6%
	Ertimur, Ferri & Oesch (2013)	2011	93.6%
	Copland, Larcker & Tayan (2018)	2017	95.3%
Equity plans	Copland, Larcker & Tayan (2018)	2017	92.7%

All of the studies listed above reported average levels of support of 92% or higher. All three studies that looked at uncontested directors' elections

154. *See* George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1312 (2014).

155. Data drawn from: Cai, Garner & Walkling, *supra* note 104, at 2403; Choi, Fisch & Kahan, *Myth or Reality?*, *supra* note 105, at 907; Copland, Larcker & Tayan, *supra* note 107, at 12; Thomas, Palmiter & Cotter, *supra* note 108, at 1245; Malenko & Shen, *supra* note 109, at 3403; Cotter, Palmiter & Thomas, *supra* note 110, at 983; Ertimur, Ferri & Oesch, *supra* note 111, at 973.

reported average levels of support above 96%. To the extent the studies listed in the table above looked at other proxy advisors' recommendations as well as ISS recommendations, they found that average levels of support tended to be slightly higher when both ISS and another firm issued positive recommendations: 97.0% (up 0.6%) in the case of the Choi, Fisch & Kahan study;[156] and 97.5% (up 0.3%) (uncontested directors' elections), 96.4% (up 0.9%) (say-on-pay), and 93.2% (up 0.5%) (equity plans) in the case of the Copland, Larcker & Tayan study (which looked exclusively at ISS and Glass Lewis recommendations).[157]

If shareholder voting with the assistance of a proxy advisor were a "one-shot game" (*i.e.*, an institutional investor hires a proxy advisor to support its voting over only a single proxy season), it might be rational for the investor to scrutinize every recommendation it receives from its proxy advisor before voting, as it might not feel it has a sufficient basis for trusting that the proxy advisor's recommendations will align with its preferences.[158] But institutional investors and their proxy advisors are in fact in a "repeat game"—institutional investors work with the same proxy advisors, year after year, over multiple proxy seasons, giving them opportunities to adapt their behavior over time in welfare-maximizing ways.[159] A rational investor that observes that it always, or almost always, agrees with its proxy advisor's recommendations when those recommendations fall into a given category (*e.g.*, positive recommendations on management proposals) would not continue incurring costs by undertaking a redundant vote-by-vote review of these recommendations. They would look for shortcuts, like one or more of the following: (i) relying on the proxy advisor's bottom-line recommendations without expending the costs involved in looking behind these recommendations, (ii) customizing its proxy voting policies to address fringe areas where the investor consistently disagrees with its proxy advisor, and (iii) implementing low-cost quality controls (*e.g.*, reviewing a random sample of the proxy advisor's voting recommendations) to provide assurance that the proxy advisor's analyses remain accurate and reflective of the investor's preferences. The proxy advisor, in turn, has an incentive to continue producing recommendations of equivalent quality so that it can keep the investor's business. What is more, such an approach would be in full accord with SEC rules and guidance as they existed prior to the SEC's 2019–2020 package of reforms.

156. Choi, Fisch & Kahan, *Myth or Reality?*, *supra* note 105, at 908.

157. Copland, Larcker & Tayan, *supra* note 107, at 12.

158. *See* Robert Axelrod & William D. Hamilton, *The Evolution of Cooperation*, 211 SCIENCE 1390, 1391 (1981); Robert D. Cooter, *Against Legal Centrism*, 81 CAL. L. REV. 417, 422–23 (1993) (reviewing ROBERT ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991)).

159. Axelrod & Hamilton, *supra* note 158, at 1391; Cooter, *supra* note 158, at 422–23.

In summary, there is reason to doubt that the research provider narrative reflects institutional investors' behavior all or even most of the time. The near-unanimous support management proposals tend to receive when those proposals are endorsed by ISS suggests that investors overwhelmingly agree with each other and with ISS when it comes to this category of proposals, year after year. There would seem to be little point in an institutional investor's fully scrutinizing recommendations that it knows it is highly likely (or perhaps almost certain) to agree with. Instead, one would expect the investor to take shortcuts allowing it to rely on its proxy advisor's recommendations without undertaking separate analysis.

III. TOWARD A MORE NUANCED ACCOUNT OF PROXY ADVISOR INFLUENCE

I argue that the mainstream accounts of proxy advisors' influence on voting outcomes fall short because they miss a central role that proxy advisors appear to play in most institutional investors' decision-making processes: that of issue spotter.[160] This role comprises helping investors distinguish controversial matters requiring independent analysis from non-controversial matters that do not require much (or perhaps any) vote-specific analysis beyond that completed by the proxy advisor, thus serving to narrow the universe of voting decisions that require these investors' active attention. On this account, in respect of most types of matters, institutional investors will consider a vote to be controversial if the proxy advisor's recommendation diverges from that of management, and non-controversial if the proxy advisor's recommendation aligns with that of management.

To the extent institutional investors are using proxy advisors as issue spotters, proxy advisors' recommendations have the power to move shareholder votes, but the nature of this power depends on the direction of the recommendation. Recommendations that align with those of management have the effect of taking matters off institutional investors' agendas, all but assuring that a vote will unfold as management had hoped. Recommendations that diverge from those of management carry much less power, as they tend to serve as a signal only that an investor should look at the information underlying the proxy advisor's recommendation as well as relevant outside sources before casting its votes. On this account, analyses pointing to proxy advisors' influence over shareholder voting outcomes are primarily capturing proxy advisors' power to give management a pass by issuing recommendations supportive of management, rather than their power to force a negative outcome for management by issuing recommendations

160. I do not argue that all institutional investors use proxy advisors as issue spotters (the robo-voters discussed in Part II.B, *supra*, clearly do not), or that proxy advisors serve only as issue spotters (for example, their research plays a separate role in informing investors' decisions on controversial matters). I argue only that issue-spotting is a role that proxy advisors appear to play in most institutional investors' processes for making voting decisions.

that oppose those of management. This point is perhaps clearer if one analogizes it to the court system: appeals of trial judgments often succeed, but this is not evidence that the losing party at trial has the power to dictate how appellate courts decide their cases. The best they can do is give the winning party a pass by declining to appeal and thus excluding their matter from the appellate court's attention.

Adopting a more nuanced account of proxy advisors' influence that incorporates their role as issue spotters allows us to reconcile the dueling empirical claims made by proponents of the blind reliance and research provider narratives. We can accept as true both the U.S. Chamber of Commerce's assertion that institutional investors typically vote in line with ISS recommendations, by also keeping in mind that the vast majority of ISS recommendations align with those of management. At the same time, we also can accept the Council of Institutional Investors' assertion that proxy advisors merely supplement the resources institutional investors spend in-house on making voting decisions, by adding the caveat that these in-house resources are focused on those matters the investor deems to be most worthy of its attention based on the direction of its proxy advisor's recommendation.[161]

This Part aims to clarify the scope of this role by looking at how it might work in the context of different types of proposals. In particular, it argues that proxy advisors appear likely to play an issue-spotting role with respect to the numerous and often uncontroversial ordinary course management and shareholder proposals (where corporate control is not in issue). However, in proxy contests (contested directors' elections), institutional investors have little need of an issue spotter because these matters are inherently controversial given that corporate control is at issue. For these matters, institutional investors are likely to value proxy advisors exclusively as research providers.

A. ORDINARY COURSE MANAGEMENT PROPOSALS

The bulk of the empirical evidence described above focuses on management proposals on ordinary course matters, such as proposals to elect directors nominated by management in uncontested elections, say-on-pay proposals, and proposals to approve new equity compensation plans. Shareholders view most of these proposals as uncontroversial, as evidenced by the high levels of support these proposals receive on average.[162] But at the same time, they know that a minority of these proposals *will* be controversial.

161. U.S. Chamber of Commerce, *supra* note 3, at 8; CII Letter, *supra* note 7, at 6.

162. BROADRIDGE & PRICEWATERHOUSECOOPERS, *supra* note 96, at 5–6; GINA LAURIERO, MIMS MAYNARD ZABRISKIE & JEFFREY LETALIEN, MORGAN, LEWIS & BOCKIUS LLP, 2020 PROXY SEASON: A RECAP OF 2019 AND TRENDS TO WATCH (2020) 7, https://www.morganlewis.com/-/media/files/publication/presentation/webinar/2020/public-company-academy/2020-proxy-season-a-recap-of-2019-and-trends-to-watch.pdf [https://perma.cc/VAF2-2VGK].

When a proxy advisor recommends voting in favor of an ordinary course management proposal, this serves as a signal that the proposal is uncontroversial and that investors should vote in line with management's (and the proxy advisor's) recommendation without spending too much time researching the basis for the recommendation. Institutional investors' reflexive support for proposals falling into this category is evidenced by the studies listed in Table 3, each of which found average support for ISS-endorsed management proposals in excess of 90%, despite covering varying types of proposals over varying time periods. Factors that might explain why ISS-endorsed management proposals do not receive even higher support on average include (i) small differences in institutional investors' proxy voting policies which may lead them to occasionally vote against an ISS-endorsed proposal, (ii) instances where another proxy advisor recommends voting against an ISS-endorsed proposal, and one or more of that proxy advisor's clients decide to side with this recommendation rather than that of ISS and (iii) dissenting votes cast by retail investors and institutional investors that are not ISS clients.

When a proxy advisor recommends voting against a management proposal, institutional investors appear to view this as a signal that the vote is controversial and should be set aside for closer analysis. Different investors may reach different decisions on these votes, as reflected in their tendency not to vote *en masse* against management in response to a negative ISS recommendation. These investors could rely on a variety of bases for reaching diverging voting decisions on the same proposal. Some investors with larger stakes in a company may have been consulted by management on the matter up for vote beforehand (management, based on its understanding of proxy advisors' policies, may have anticipated that the matter would be controversial),[163] and vote in line with management because they were persuaded by the case previously made by management. Alternatively, large investors might exercise effective control over a company and thus have overseen the formulation of the proposals up for vote. Other investors might wait for management to file supplemental proxy materials in response to the proxy advisor's recommendation and take these materials into account before voting, while others might be inclined to give management the benefit of the doubt if the company has been generating adequate returns.[164]

163. *See* Ertimur, Ferri & Oesch, *supra* note 111, at 969 ("for most items on the ballot, [proxy advisors'] recommendations are largely anticipated and there is limited incremental information in [proxy advisor] reports").

164. *See, e.g.*, Fisch, Palia & Davidoff Solomon, *supra* note 113, at 101 (finding, based on say-on-pay voting outcomes, that "shareholders do not appear to care about executive compensation unless an issuer is performing badly"). Others suggest deference to management could reflect more self-interested motives. For example, more deference could pay dividends to a mutual fund sponsor if it means company managers are more inclined to include that sponsor's mutual funds as an investing option for company employees' retirement plans. *See* Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1176–82 (2019).

Viewing proxy advisors as issue spotters helps resolve a tension between the findings of Choi, Fisch & Kahan and those of Malenko & Shen. Choi, Fisch & Kahan look at an entire universe of uncontested directors' elections and find that ISS's influence on voting outcomes could be as low as 6.4 percentage points,[165] whereas Malenko & Shen, focusing on companies sitting along a borderline ISS used to set companies aside for closer review, found that ISS's influence likely is around 25 percentage points.[166] If ISS's influence stems from its ability to focus institutional investors on some proposals and not others, this influence should appear strongest close to any cut-off ISS uses when developing its recommendations. Those companies on the right side of ISS's cut-off are well-placed to escape investor scrutiny and receive overwhelming support on the management proposals up for vote. Those on the wrong side of the cut-off will face investor scrutiny, with different investors reaching different verdicts based on their view of management's track record and the merits of the relevant proposals. When one looks at the entire universe of recommendations made by a proxy advisor, however, these borderline cases should tend to be overwhelmed by clearer cases for which factors outside of the particulars of the proxy advisor's process for reaching recommendations provide ready explanations for differences in voting outcomes. This would lead one to reach a lower estimate of the marginal impact of a proxy advisor recommendation.

B. ORDINARY COURSE SHAREHOLDER PROPOSALS

Proposals introduced by shareholders can cover matters as wide-ranging as corporate governance (*e.g.*, a proposal to separate the role of board chair from that of CEO), labor rights, and environmental sustainability. These proposals are almost always opposed by management and tend to have a low probability of succeeding.[167] In this context, a proxy advisor's role may be to help investors separate those shareholder proposals that merit closer attention from those that ought to be rejected out of hand.

Thomas, Palmiter & Cotter reached results broadly consistent with this account. Shareholder proposals on executive pay opposed by both management and ISS received 11% support on average, compared to 39.9% for proposals endorsed by ISS and opposed by management, a difference of 28.8%.[168] A 2012 report by the Manhattan Institute reviewed ISS

165. Choi, Fisch & Kahan, *Myth or Reality?*, *supra* note 105, at 903.

166. Malenko & Shen, *supra* note 109, at 3404.

167. JAMES R. COPLAND, YEVGENIY FEYMAN & MARGARET O'KEEFE, PROXY MONITOR 2012: A REPORT ON CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM (2012) 18, https://www.proxymonitor.org/pdf/pmr_04.pdf [https://perma.cc/GZ6M-7EM4]; Thomas, Palmiter & Cotter, *supra* note 108, at 1245.

168. Thomas, Palmiter & Cotter, *supra* note 108, at 1245. These findings are distinct from the authors' findings with respect to management-presented say-on-pay proposals, which are described in Table 1. Note that the authors report levels of support for eight types of executive pay shareholder proposals; the figures reported above are a weighted average of this data.

recommendations and voting outcomes with respect to shareholder proposals introduced at Fortune 200 companies from 2006 through 2012, finding that positive ISS recommendations are associated with a 15 percentage point boost in shareholder support on average.[169] The report also found that the gap between a proposal's likelihood of success and its likelihood of receiving an ISS endorsement tended to vary widely depending on its subject matter. For example, while ISS endorsed 70% of proposals on political spending and lobbying, only 1% received majority support. By contrast, ISS endorsed 97% of board declassification proposals and 84% received majority support.[170] This data appears consistent with the notion that institutional investors are reviewing and exercising independent judgment on ISS recommendations that differ from those of management.

The report suggests, however, that ISS may not be doing an effective job of winnowing down voting decisions for institutional investors. While ISS endorsed over 63% of all shareholder proposals covered by the study, only 8% of shareholder proposals received majority support.[171] The report speculated that ISS's general policies on shareholder proposals may be calibrated to the preferences of a subset of its clients from which it generates significant revenues, "social investment vehicles and labor-union pension funds," rather than to the preferences of its client base as a whole,[172] leading it to flag proposals that most of its clients generally would not consider supporting. Another possibility is that ISS was spotting issues correctly, and that the bulk of its clients simply had not caught up with ISS's thinking in this area. While proposals on environmental and social matters might have been regarded as fringe issues at the time the report was published, the strong expressions of support for more corporate action on climate change and human rights expressed by major institutional investors such as BlackRock and Vanguard leave one with the impression that ISS was ahead of the curve,[173] notwithstanding the Trump-era DOL's comments on the matter in its 2020 rulemaking.[174] Even if ISS's general policies in this area were not well-tailored to its clients' objectives, these clients could have responded by customizing their voting policies so that ISS's issue-spotting activities more closely align with their views on which shareholder proposals merit attention.

169. Copland, Feyman & O'Keefe, *supra* note 167, at 3.

170. *Id*. at 23.

171. *Id*. at 3.

172. *Id*. at 23.

173. *See, e.g.*, Peter Reali & Anthony Garcia, Nuveen, LLC, *Proxy Season Rising Demand for Board Oversight of ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 11, 2019), https://corpgov.law.harvard.edu/2019/09/11/proxy-season-rising-demand-for-board-oversight-of-esg/ [https://perma.cc/M4DW-9GMN]. *See also* Keith Johnson, Cynthia Williams & Ruth Aguilera, *Proxy Voting Reform: What is on the Agenda, What is Not on the Agenda, and Why it Matters for Asset Owners*, 99 B.U. L. REV. 1347, 1353–55 (2019).

174. DOL Proposed Rules, *supra* note 17, at 55,223.

If this is the case, ISS's efficacy at spotting issues for its clients may be better than the statistics highlighted in the report indicate.

C. PROXY CONTESTS

Institutional investors need no assistance spotting issues in proxy contests. Contested directors' elections come with high stakes for shareholders, as the victory of a dissident slate of director nominees can mean significant changes in a company's strategy, potentially resulting in a company merger or breakup.[175] All parties to the contest can be expected to wage campaigns for shareholder support, such that investors should have access to substantial information on the issues at the center of the contest.[176] Because proxy contests are relatively rare, ranging at about 50 per year in the United States over 2016–2019 in contrast to the thousands of say-on-pay resolutions and uncontested director nominations one sees annually,[177] institutional investors should for the most part be able to afford to independently analyze and make voting decisions when such a contest arises at a company in its investment portfolio.

In this context, proxy advisors may serve exclusively as research providers, with their reports helping institutional investors sift through the information underlying the competing narratives promoted by the management and dissident slates of director nominees to reach a voting decision. The study by Brav, Jiang, Li & Pinnington,[178] which examines mutual fund voting in proxy contests at U.S. companies between 2008 and 2015, suggests a level of heterogeneity in mutual fund voting that seems to reflect their reaching different, independent judgments regardless of ISS's bottom line recommendation. The authors found that, on average, dissidents with ISS support received 57.5% of mutual funds' votes, compared with 17.8% in the case of dissidents without ISS support (a difference of about 40%).[179] These averages do not reflect the kind of overwhelming average levels of support that would suggest blind reliance on the proxy advisor's bottom-line recommendation. But the size of the voting swing, together with the authors' finding that an endorsement from ISS increased a dissident's chance of victory by 35%,[180] suggests that mutual funds (and likely other investors) tend to give ISS recommendations serious weight in making voting decisions.

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175. *See, e.g.*, *2018 Review of Shareholder Activism,* LAZARD, 3–5 (2019), https://www.lazard.com/media/450805/lazards-2018-review-of-shareholder-activism.pdf [https://perma.cc/V4CY-GG79] (reporting outcomes of various proxy contests in 2018).

176. Katherine W. Kelley, *Kullman: Tactics for Winning a Proxy Fight*, NACD BOARDTALK (Oct. 19, 2017), https://blog.nacdonline.org/posts/how-to-win-a-proxy-fight [https://perma.cc/6NGS-93MP].

177. *See* Copland, Larcker & Tayan, *supra* note 107, at 12.

178. Brav, Jiang, Li & Pinnington, *supra* note 116.

179. *Id*. (manuscript at 17).

180. *Id*. (manuscript at 4).

Another study, by Alexander, Chen, Seppi & Spatt, looked at the price impact of ISS recommendations on proxy contests over 1992–2005 to try and understand how investors view these recommendations.[181] The authors found that an ISS endorsement of a dissident slate was followed by an increase in the company's stock price, attributable to two factors: (i) investors' perception that the dissident's chance of winning is higher,[182] and (ii) increased confidence that the dissidents, if victorious, will be able to increase the company's value.[183] The authors reasoned that the quality of a dissident and its plans for the company may be difficult for investors to assess, such that they would place value on a "certification" of that dissident by ISS.[184]

In summary, investors have little need for an issue spotter when it comes to proxy contests because all proxy contests raise significant issues requiring their attention. Rather, it appears investors tend to use proxy advisors as a source (but by no means their sole source) of information and guidance, with their recommendations providing indicators not only of a dissident's chances of success but of the underlying quality of the dissident and its plans for the company.

IV. IMPLICATIONS FOR PROXY ADVISOR REGULATION

The SEC's package of proxy advisor reforms aim to address at least three different, though overlapping, failure scenarios for the delivery of proxy advice: (i) the proxy advisor uses low-quality standards for developing its recommendations, defined here as standards that fail to serve their intended goals even if they are correctly applied; (ii) the proxy advisor delivers low-quality recommendations, defined here as recommendations that fail to reflect its standards (*e.g.*, as a result of bias or factual or analytical errors); and (iii) the proxy advisor's clients make low-quality voting decisions (whether due to defects in the proxy advisor's advice or other factors). Critics of the SEC's reforms point to a fourth possibility that excessive regulation will reduce the supply of and demand for proxy advice, in turn making it more difficult for shareholders to cast informed votes and engage in meaningful oversight of public company managers.[185]

181. Alexander, Chen, Seppi & Spatt, *supra* note 119. Unlike recommendations on ordinary course management and shareholder proposals, ISS recommendations on proxy contests typically are made public, often by the party that received ISS's endorsement. *Id*. at 4424.

182. The authors find that an ISS endorsement increased a dissident's probability of success by between 14% and 30%. *Id*. at 4422. This estimate is lower than that reached by Brav, Jiang, Li & Pinnington, likely reflecting the authors' older sample of contests (proxy advisors' client bases grew significantly over the 1990s and early 2000s). *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 94, at 13.

183. Alexander, Chen, Seppi & Spatt, *supra* note 119, at 4452.

184. *Id*. at 4451.

185. *See, e.g.*, Dent, *supra* note 154, at 1304–06; Cappucci, *supra* note 56, at 610–11.

After briefly reviewing the possible effects of more burdensome proxy advisor regulation, this Part examines the implications that taking proxy advisors' role as issue spotters into account may have for different proposals to address the three failure scenarios listed above. In respect to the first scenario, it turns on its head a frequent criticism of proxy advisors' standards, reflected in the SEC's reforms—that their one-size-fits-all approach to corporate governance fails to account for the circumstances of particular issuers and thus results in too many recommendations to vote in opposition to management. To the extent negative recommendations serve only to focus investors' attention, erring on the side of providing such recommendations is not objectionable. The real problem may be that proxy advisors' standards result in too few negative recommendations. Issuers could exploit weaknesses in these standards to secure positive recommendations despite problematic practices, thus increasing the likelihood that these practices will escape investors' notice. The SEC's reforms do not address this problem. As part of the review of proxy advisor regulation expected to be conducted under the Biden Administration,[186] it could be worthwhile for the SEC to explore mitigating this problem through guidance that encourages investment advisers to review records of their past votes to identify potential weaknesses in their proxy advisor's voting standards and work with the proxy advisor to resolve them. The DOL could provide parallel guidance to those investment fiduciaries under its oversight.

Turning to the second scenario, incorporating an understanding of proxy advisors' role as issue spotters points toward a more focused approach to regulating the presentation and delivery of proxy advisor recommendations, and any response from the issuer, than that adopted by the SEC. The SEC's reforms should have focused on helping institutional investors access new signals about the quality of these recommendations of which they would not otherwise have been aware. Instead, the reforms impose a variety of new, at times burdensome requirements that appear to signal problems that investors are already aware of and have adapted to.

For the third scenario, this account suggests that, instead of issuing guidance that could be viewed as imposing new procedural hurdles to voting on the vast majority of investors that appear not to blindly rely on their proxy advisors' recommendations, the SEC should focus its attention on the small minority of investors that cast their votes in lockstep with proxy advisor recommendations. The SEC would be right to question whether this small minority is in fact exercising its voting rights prudently, or whether these investors are simply imposing unnecessary costs on its clients in an effort to shield themselves from liability under current rules and guidance. A targeted response to this problem could include guidance reiterating that investment advisers can agree with their clients not to exercise voting rights when they

186. Coffee, *supra* note 15.

believe the costs of doing so likely will exceed the benefits, and adding that in assessing these costs investment advisers should consider the cost of independently reviewing proxy advisor recommendations on controversial matters.

A. PREFACE: POSSIBLE EFFECTS OF MORE BURDENSOME REGULATION

As illustrated in Part I, the proxy advisors' growth likely was not a result of market forces alone. Regulation likely helped generate demand for proxy advisors' services and fostered growth in the supply of these services. Regulation also could impose costs that have the opposite effects, casting a shadow over any proposal aimed at addressing proxy advisors' perceived failings. On the supply side, these costs are salient because proxy advisors do not appear well-placed to absorb these costs on their own and, accordingly, it is likely that these costs would cascade to institutional investors, issuers (particularly smaller issuers), and retail investors. On ISS's and Glass Lewis's ability to absorb costs, two points are relevant: (i) despite their dominance of the proxy advisory market, they do not reap monopoly-like profits, [187] and (ii) the already massive and still-growing volume of management and shareholder proposals requiring recommendations each year, largely "crammed into a four-month proxy season," only makes proxy advisors' compliance challenges more daunting.[188] While proxy advisors could try to pass higher costs on to their clients, small and mid-size institutional investors may be unwilling to pay them. SLB 20 already notes that there is nothing preventing investment advisers from agreeing with their clients not to exercise voting rights if the costs of exercising these rights exceed the expected benefits.[189] As such, a rational response to higher prices may be to stop using proxy advisors altogether (and most likely either stop voting or adopt a blanket policy of always voting in line with management recommendations).

If proxy advisors cannot pass on the costs of more burdensome regulation through higher prices, they could try to do so through at least two other means. First, by providing lower-quality research and advice. For example, if proxy advisors were required to clear their recommendations through management as had been contemplated under the Proposed Rules,[190] their path of least resistance would have been to abandon the notion of providing objective advice and instead provide advice favorable to management. As one market participant has observed, if proxy advisors "believe that every disagreement over a subjective determination like a say-on-pay vote is likely

187. Dent, *supra* note 154, at 1308.
188. *Proxy Advisory Business: Apotheosis or Apogee?,* LATHAM & WATKINS LLP (Mar. 2011), https://www.lw.com/upload/pubContent/_pdf/pub4042_1.pdf [https://perma.cc/5FSP-52NA].
189. SLB 20, *supra* note 60, at Question 2.
190. Proposed Rules, *supra* note 67, at 66530.

to lead to a messy confrontation with management, they may be less inclined to issue negative advice."[191] Second, proxy advisors could reduce the number of companies they cover. This probably would mean limiting their coverage to large companies, in which the largest number of their clients invest. Institutional investors might divest from smaller companies if these companies no longer are covered by proxy advisors, leaving these investors' beneficiaries less diversified and making it even more difficult for emerging companies to raise capital in the public markets.[192]

More burdensome regulation also may discourage others from providing proxy advice, further impairing competition in this sector. While existing barriers to entry already make it unlikely that another business similar to ISS will emerge, one could foresee, for example, non-profit organizations providing proxy advice on specific issues of interest (*e.g.*, shareholder proposals on environmental, social and governance matters) in conjunction with more general advocacy on these issues.[193] One also could foresee groups of institutional investors establishing co-operatives to pool their resources for overseeing portfolio companies.[194] Could more burdensome regulation have a chilling effect on these kinds of activities? At a minimum, it might require these organizations to exercise additional care—and thus expend additional costs—ensuring that their activities as structured would not be treated as proxy advice under SEC rules. At worst, it could deprive investors of a diversity of views on corporate governance and sources of information to inform their votes, potentially reducing the quality of their voting decisions.

Moving briefly to the demand side, regulation that requires institutional investors to undertake additional diligence in overseeing their proxy advisors could lead these investors to decide that exercising their voting rights is not worth the cost. To the extent such regulation leads institutional investors that adopt blanket policies of voting with a proxy advisor to stop voting, this regulation could be beneficial if it results in more informed and engaged institutional investors' having a greater voice in shareholder votes. If such regulation leads relatively informed investors to disengage from voting, however, then it may be harmful.

Timing may be relevant to drawing a prudent boundary between helpful and harmful regulation. Because of the time crunch institutional investors face during proxy season, rules that require them to exercise additional diligence *before* casting their proxies seem likely to have the most significant

191. Cappucci, *supra* note 56, at 610–11.

192. Dent, *supra* note 154, at 1304–05.

193. *See id*. at 1302 (describing potential alternative sources of advice available to institutional investors).

194. *See* Tuch, *supra* note 35 (discussing the rise of similar entities in the U.K. to fulfill functions similar to those now fulfilled by proxy advisors in the United States). *See also* Edward J. Waitzer & Douglas Sarro, *Fiduciary Society Unleashed: The Road Ahead for the Financial Sector*, 69 BUS. LAW. 1081, 1103–04 (2014) (describing collaborative efforts by shareholders to foster good governance).

adverse effects on demand for proxy advice, especially if such requirements do not reflect current market practice. Rules that require investors only to review their votes *after* their proxies have been cast and address any deficiencies discovered on a going-forward basis, as suggested in SLB 20,[195] may be easier to implement and thus lead fewer investment advisers to cease trying to cast informed votes.

B. REEVALUATING "ONE-SIZE-FITS ALL" STANDARDS

Understanding proxy advisors' role as issue spotters casts one criticism of the quality of proxy advisors' standards—that they reflect a "one-size-fits-all"[196] or "cookie-cutter"[197] approach to analyzing the quality of issuers' corporate governance that does not reflect each company's unique set of circumstances or investors' diverse objectives[198]—in a new light that exposes a potential weakness in these standards that is unaddressed by the SEC's reforms.

Critics of proxy advisors' methodologies assert that, because good governance requires different practices in different circumstances, one-size-fits-all policies must be low-quality, and institutional investors' use of proxy advisors that employ such policies means they must not be paying sufficient attention to their obligations to exercise their voting rights prudently.[199] The SEC's reforms reflect a more specific concern that these one-size-fits-all policies result in too many negative (*i.e.*, anti-management) recommendations. Consider, for example, the SEC's guidance emphasizing that institutional investors should look for and place weight on issuers' responses to proxy advisor recommendations, and its rules requiring proxy advisors to have a framework in place for conveying issuers' responses to their clients. These reforms only come into play in the event of a recommendation that management disagrees with—management will not rebut a recommendation to vote "For" its own say-on-pay proposal, for example.

To the extent institutional investors are using proxy advisors as issue spotters, one-size-fits-all policies that err on the side of providing negative recommendations can be seen in a different light. Crudely drawn cut-offs are unlikely to achieve perfect recommendations, but they can quickly and cheaply screen out votes that are clearly uncontroversial. To the extent an

195. SLB 20, *supra* note 60, at Question 1.

196. CTR. FOR CAPITAL MKTS. COMPETITIVENESS & NASDAQ, *supra* note 18, at 3; CHESTER S. SPATT, PROXY ADVISORY FIRMS, GOVERNANCE, MARKET FAILURE, AND REGULATION 12–13 (2019), https://milkeninstitute.org/sites/default/files/reports-pdf/Proxy%20Advisory%20Firms%20FINAL.pdf [https://perma.cc/9VYH-YVG8].

197. Letter from Tom Quaadman, Exec. Dir., Fin. Reporting and Inv'r Opportunity, Ctr. for Capital Mkts. Competitiveness, to The Hon. Mary Schapiro, Chairman, SEC, at 3 (Aug. 5, 2010), https://www.sec.gov/comments/s7-14-10/s71410-26.pdf [https://perma.cc/GX92-P4YT].

198. Spatt, *supra* note 196, at 14; Copland, Larcker & Tayan, *supra* note 107, at 17.

199. *See* Copland, Larcker & Tayan, *supra* note 107, at 17.

institutional investor wants to cast votes that reflect its objectives and hear more from management on proposals the investor regards as controversial, it may be to the investor's advantage to hire a proxy advisor that uses crude cut-offs that err on the side of contradicting management recommendations. It allows the investor to deal quickly and cheaply with the massive proportion of issues that clearly are uncontroversial while giving the investor freedom to analyze and make prudent decisions on the limited universe of matters that require closer judgment calls.

One-size-fits-all policies could fail, however, to the extent they err on the side of supporting management recommendations. This is a problem the reforms described above do not address, despite there being reason to suspect that this problem exists. Public company managers have a strong interest in designing governance and compensation structures to avoid proxy advisor scrutiny, but not necessarily to design them in ways that further the objectives behind proxy advisors' voting standards. Managers can invest significant time and effort to find creative ways to skirt these standards, possibly with the assistance of the governance consultants housed within a proxy advisor's business. Managers might even try to game the various financial metrics proxy advisors use to screen compensation proposals for further review.[200] Proxy advisors' research staff, by contrast, have limited time and other resources to review the quality of these proposals and, assuming the firewalls between research and governance consulting staff are effective, will not know whether these proposals reflect advice from their in-house governance consultants. Research uncovering the strong influence financial performance metrics play in shaping ISS recommendations on say-on-pay votes, without regard to the strength of the relationship between pay and performance reflected in the compensation structures up for vote, could reflect efforts by research staff to triage resources that result in poor compensation structures slipping by.[201]

Proxy advisors and institutional investors likely will be unable to spot these types of proposals in real-time without incurring prohibitive costs, but retrospective analyses of proposals that may have been misclassified as uncontroversial might foster gradual improvements in proxy advisors'

200. There has been at least some suggestion in the popular press that management may be able to game these metrics. Shawn Tully, *CEO Pay May Soon Face a New, Hard-to-Manipulate Yardstick As ISS Embraces 'EVA'*, FORTUNE (Mar. 28, 2019), https://fortune.com/2019/03/28/iss-ceo-pay-eva/ [https://perma.cc/P5ZW-AZ7P]. This practice does not appear implausible in light of research highlighting CEOs' tendency to cherry-pick peer groups to justify upward movements in executive pay. *See* Mathijs de Vaan, Benjamin Elbers & Thomas A. DiPrete, *Obscured Transparency? Compensation Benchmarking and the Biasing of Executive Pay*, 65 MGMT. SCI. 4299, 4299, 4315 (2019).

201. Fisch, Palia & Davidoff Solomon, *supra* note 113, at 116–117. To some extent, these triage mechanisms likely also reflect proxy advisors' anticipation of their clients' preferences—even in the face of a negative ISS recommendation, institutional investors are inclined to give a say-on-pay proposal the benefit of the doubt if an issuer's financial performance is deemed satisfactory. *Id*.

standards. The SEC could provide guidance recommending that investment advisers review, at least annually, a sample of the recommendations they received from their proxy advisor to determine whether these recommendations align with the objectives that underlie their proxy voting policies. Investment advisers could be asked to focus their review on relatively complex matters, such as say-on-pay votes, and provide feedback to their proxy advisor based on this review. Such guidance would have the added benefit of increasing institutional investors' participation in the ongoing development of proxy advisors' voting standards, something which has been lacking despite proxy advisors' efforts to solicit their clients' opinions on this front.[202] Such guidance also would have the advantage of being incremental—it builds on the guidance in SLB 20 recommending retrospective reviews of proxy advisor recommendations.[203] As a final note, the DOL also could explore providing similar guidance to the investment fiduciaries under its oversight.

C. IMPROVING (DEBATE OVER) PROXY ADVISOR RECOMMENDATIONS

The Proposed Rules sought to address the perceived problem of low-quality proxy advisor recommendations through rules aimed at (i) improving the quality of these recommendations by allowing issuers to review and comment on draft recommendations; and (ii) signaling potential problems with these recommendations to proxy advisors' clients through enhanced conflict of interest disclosures and measures that enhance issuers' opportunity to respond to proxy advisor recommendations and place these responses in front of investors. The Final Rules abandoned the first objective but pressed forward with the second. Abandoning the first objective makes sense: a prior issuer review period would have been highly burdensome given the limited time proxy advisors have to formulate recommendations, and probably unnecessary given that it appears institutional investors tend not to blindly rely on proxy advisor recommendations. But the collection of surviving measures designed to further the second objective is far from unproblematic.

On an understanding of proxy advisors as issue spotters, the criterion for evaluating these measures is whether they serve to provide signals that meaningfully inform an institutional investor's decision on a controversial matter. To the extent these measures merely repeat information of which institutional investors are already aware or signal risks that these investors

202. *See* David F. Larker, Allan L. McCall & Brian Tayan, *And Then A Miracle Happens!: How Do Proxy Advisory Firms Develop Their Voting Recommendations?*, STAN. CLOSER LOOK SERIES 2 (Feb. 25, 2013), https://ssrn.com/abstract=2224329.

203. SLB 20, *supra* note 60, at Question 1.

already mitigate through other means, the benefit of these measures is less clear.

The Final Rules' general requirement that issuers receive a copy of proxy advisor reports at least contemporaneous with these reports' distribution to clients is most defensible under this criterion.[204] This measure would help ensure issuers have an opportunity to review these reports and formulate their response, potentially placing relevant information in front of investors before a vote. The costs of this requirement would seem relatively low. It would not slow down or increase the burden of developing proxy advisor recommendations. This requirement would not set the bar much higher than current practice at ISS, which provides final copies of its reports to issuers upon request, after dissemination to clients.[205]

The case for the Final Rules' requirement that proxy advisors effectively act as go-betweens between issuers and investors, notifying their investor clients when an issuer plans to respond to one of their recommendations and passing links to these responses when they become available on EDGAR, is less clear. This measure seems predicated on the assumption that institutional investors will not bother to look for or consider supplemental information filed by issuers unless they receive it directly from their proxy advisor. On the account adopted in this article, it stands to reason that institutional investors will understand that, when a proxy advisor's recommendation diverges from that of management, management likely will seek to respond and the investor will know to look for such a response. Requiring proxy advisors to alert investors to such responses adds nothing new, while imposing additional burdens on proxy advisors and creating an incentive for them to provide less objective advice. An easy way to avoid the hassle of checking for and relaying issuers' notices and disclosures to clients, and limit the risk of liability for failures to relay these messages in an effective way, would be to simply issue more recommendations supportive of management. To the extent the real problem is that issuers' responses to proxy advisor recommendations are difficult to find, a less burdensome alternative would be to require proxy advisors to include in their reports a link to the relevant issuer's page on EDGAR, where any response filed by the issuer will become available.[206]

Conflicts of interest are a legitimate concern, and the requirements included in the Final Rules that proxy advisors provide disclosure about these conflicts and how they are handled appear unobjectionable.[207] But their

204. This requirement appears in 17 C.F.R. § 240.14a-2(b)(9)(ii)(A) (2020).

205. *FAQs: Engagement on Proxy Research*, ISS, https://www.issgovernance.com/contact/faqs-engagement-on-proxy-research/ [https://perma.cc/3YBE-XMJP].

206. Letter from James C. Allen, Head, Capital Mkts. Pol'y, and Matt Orsagh, Dir., Capital Mkts. Pol'y, CFA Inst., to Vanessa A. Countryman, Sec'y, SEC, at 4 (May 13, 2020), https://www.sec.gov/comments/s7-22-19/s72219-7182919-216808.pdf [https://perma.cc/HG6Z-5LJR].

207. These requirements appear in 17 C.F.R. § 240.14a-2(b)(9)(i) (2020).

ultimate benefit may be marginal at best. The new disclosure requirements mirror those applicable to research analysts, who must disclose if their firm provides investment banking services to an issuer that is the subject of their research, even if firewalls between the firm's investment banking and research services are in place.[208] They also appear only to build incrementally on proxy advisors' existing practices for disclosing conflicts of interest: ISS already has processes that allow their investor clients to find out whether an issuer that is the subject of ISS research has received governance advice from ISS.[209] The Final Rules would, however, make this information easier for investors to access. The benefits of this increased ease of access to more specific information about proxy advisors' conflicts of interest may be muted, however, as institutional investors already appear aware that these conflicts can arise and have employed various means of controlling for these conflicts. For example, ISS's efforts to isolate its proxy advisory and voting practice from its corporate governance advisory practice[210] likely reflects institutional investors' attention to potential conflicts of interest and their demand for mechanisms that address these conflicts. Institutional investors' practice of hiring multiple proxy advisors can be viewed as yet another mechanism by which they can avoid their votes' being tainted by their proxy advisors' conflicts of interest[211]—competition among proxy advisors has been cited as a factor that mitigates the harms that can come from conflicts of interest.[212]

D. RESPONDING TO ROBO-VOTING

The SEC's guidance stating that investment advisers should work to take issuers' responses to proxy advisor recommendations into account before

208. *See, e.g.*, FINRA Rules 2241(b)(2), (c)(4), FINRA, https://www.finra.org/rules-guidance/rulebooks/finra-rules/2241 [https://perma.cc/2NU2-6WGF]. A research analyst also must disclose various other relationships that could be material to the objectivity of their advice.

209. Letter from Gary Retelny, President & CEO, Institutional S'holder Servs., to Brent J. Fields, Sec'y, SEC, at 14 (Nov. 7, 2018), https://www.issgovernance.com/file/publications/iss-roundtable-comment-letter.pdf [https://perma.cc/4MBJ-LACT].

210. INSTITUTIONAL S'HOLDER SERVS., DUE DILIGENCE COMPLIANCE PACKAGE 7–9, ISS (2017), https://www.issgovernance.com/file/duediligence/Due-Diligence-Package-November2017.pdf [https://perma.cc/VR8B-3J7M].

211. Amy Freedman & Ian Robertson, Kingsdale Advisors, *Understanding the Impact of America's Clampdown on Proxy Advisors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 10, 2019), https://corpgov.law.harvard.edu/2019/11/10/understanding-the-impact-of-americas-clampdown-on-proxy-advisors/ [https://perma.cc/5LSH-W73Z]. Competing proxy advisors' recommendations are far from uniform, such that hiring multiple advisors should tend to provide investors with diverse views on matters up for vote. *See, e.g.*, Ertimur, Ferri & Oesch, *supra* note 111, at 953 (finding that, with respect to the recommendations in their sample, ISS and Glass Lewis agreed only 17.9% of the time when it came to "Against" recommendations).

212. Tao Li, *Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry*, 64 MGMT. SCI. 2951, 2951 (2018).

voting,[213] and apply a "higher degree of analysis" to matters relating to corporate control,[214] is consistent with how one would expect investment advisers and other institutional investors to act when they are using proxy advisors as issue spotters and accordingly should be uncontroversial. Its guidance indicating that investment advisers should consider sampling pre-populated votes to test for compliance with applicable voting policies before these votes are cast[215] may prove more burdensome to the extent it does not already reflect market practice. The need for such guidance is also unclear. If there were widespread problems with these votes, they would have been revealed in the periodic, post-vote quality checks contemplated under SLB 20, yet the SEC's new guidance points to no evidence of problems detected in these quality checks that might justify asking investment advisers to take the more burdensome step of carrying out these quality checks before votes are cast.

A better area of focus would have been the small minority of institutional investors that vote in line with proxy advisor recommendations close to 100% of the time. If institutional investors (particularly those that are large and well-staffed) tend to view proxy advisors' one-size-fits-all voting standards merely as simple ways of narrowing the universe of voting decisions that require independent analysis, is it prudent for other institutional investors to rely entirely on these recommendations in determining how to vote on all matters?[216] Even if an institutional investor does not view this approach as prudent, it may have felt obligated under pre-2019 rules and guidance to cast votes on all matters so long as it can afford to hire a proxy advisor to automatically populate and cast its votes.[217] While existing SEC guidance discusses in general terms investment advisers' ability to agree with their clients to limit the scope of their obligation to exercise voting rights where the costs of voting appear likely to exceed their benefits,[218] the SEC could add to this guidance by stating in clearer terms that these costs should be viewed as including the cost of separately reviewing controversial matters. Such guidance would give smaller institutional investors leeway to cut back the amount of voting they engage in to reflect their more limited resources, in turn lowering costs for these investors' beneficiaries. Such guidance

213. This requirement is discussed in Supplemental Investment Adviser Guidance (2020), *supra* note 68, at 55,156.

214. Investment Adviser Guidance (2019), *supra* note 66, at 47,424.

215. *Id*.

216. One can accept the prudence of using proxy advisors as issue spotters while still questioning individual investors' motivations behind their votes on controversial issues. Regarding these potential motivations, *see supra* notes 163–164 and accompanying text.

217. Such an assumption could flow from the general statements in the Avon Letter and Proxy Voting Rules that voting rights are fiduciary assets. *See generally supra* Part I.A. *See also* Copland, Larcker & Tayan, *supra* note 107, at 17 (asserting that institutional investors "are *required* by the SEC to vote all matters put forth on the proxy" (emphasis in original)).

218. SLB 20, *supra* note 60, at Question 2.

should not substantially reduce demand for proxy advisors' services, since it appears institutional investors already tend to scrutinize proxy advisors' analyses of controversial matters before casting their proxies.

At first glance, the DOL's 2020 rulemaking could be seen as providing a template for future SEC action on this issue. The DOL's final rules state that ERISA fiduciaries must consider the costs of voting,[219] and can address situations where these costs appear likely to exceed the corresponding benefits by adopting a policy limiting exercises of voting rights to specific issues, specific companies in their portfolio, or some combination of the two.[220] The trouble is that these components may interact with at least two other pieces of the rulemaking so as to do more than simply curb robo-voting. First, the DOL's instruction to focus exclusively on *economic* interests[221] skews the benefits side of the investor's cost-benefit analysis, making intervention on the environmental, social, and governance issues raised in many shareholder votes more difficult to justify. Second, the instruction to "[e]valuate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights"[222] acts on the costs side of the analysis, by implying that investors must spend resources separately evaluating even non-controversial votes (as opposed to simply relying on their proxy advisor's recommendation). It is unclear what benefit is served by requiring case-by-case evaluations of non-controversial votes, and as outlined in Part II.C many investors likely would encounter significant difficulty meeting this burden. In these ways, the DOL rulemaking seems to do more than just discourage robo-voting—it seems to stack the deck to make shareholder voting as a general matter more difficult to justify. As such, its components should be viewed with caution in any review of the SEC's approach to proxy advisor regulation.

CONCLUSION

Neither of the two dominant accounts of proxy advisors' influence over their clients' voting behavior appears to provide a complete picture of how institutional investors use proxy advisors' research and recommendations. Contrary to what many proponents of additional proxy advisor regulation assert, institutional investors do not seem to blindly follow the recommendations of their proxy advisors regardless of the nature of the recommendation. At the same time, however, it seems implausible that institutional investors are using proxy advisors purely as research providers, and as a result subjecting all matters up for vote to equivalent scrutiny. This article argues that these accounts overlook an important role that proxy

219. 29 C.F.R. § 2550.404a-1(e)(2)(ii)(B) (2020).
220. 29 C.F.R. § 2550.404a-1(e)(3)(i) (2020).
221. 29 C.F.R. §§ 2550.404a-1(e)(2)(ii)(A), (C) (2020).
222. 29 C.F.R. § 2550.404a-1(e)(2)(ii)(D) (2020).

advisors play: that of issue spotter. This role involves distinguishing controversial votes from non-controversial votes so that institutional investors can focus their limited resources on reaching decisions about controversial votes. When a proxy advisor's recommendation aligns with that of management, this generally serves as a signal that the vote is uncontroversial, and that the institutional investor should rely on the proxy advisor's recommendation without spending time reviewing the research supporting that recommendation. When the opposite is true, this serves as a signal that the vote is controversial, and accordingly that the institutional investor should pay greater attention to the proxy advisor's underlying research and review additional sources (*e.g.*, supplemental proxy materials prepared by management) before voting.

Adopting a view of proxy advisors' role that accounts for their function as issue spotters leads to at least three implications for proxy advisor regulation. *First*, contrary to critics' assertion that proxy advisors' voting standards result in too many recommendations opposing management (as a result of their being one-size-fits-all), the real problem may be that they result in too few such recommendations. Managers could exploit weaknesses in these standards to secure positive recommendations, such that problematic practices escape investors' notice. Guidance encouraging investment advisers to review their past votes to identify potential weaknesses in their proxy advisor's voting standards and work with the proxy advisor to resolve them could mitigate this risk. *Second*, regulation should focus on helping investment advisers access new signals about the quality of proxy advisors' recommendations, rather than reminding them of obvious issues that only a "blind reliance" investor would miss (*e.g.*, proxy advisors' possible conflicts of interest). *Third*, instead of imposing new procedural hurdles to voting on all advisers, it may make more sense to give the small minority that cast their votes in lockstep with these recommendations comfort that they can scale back their exercise of voting rights while still complying with their fiduciary obligations.