

# COMPLIANCE WEEK

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## The Filing Cabinet



“The Filing Cabinet” is written by Melissa Klein Aguilar, a long-time business journalist who first began writing for Compliance Week in 2005. She closely follows all issues related to SEC registrants, Sarbanes-Oxley compliance, evolving securities rules, and executive compensation, among other areas. She welcomes questions, comments and statements from readers on SEC filing matters, and where appropriate she will try to address them here. She can be reached via email at [Melissa@complianceweek.com](mailto:Melissa@complianceweek.com).

## March 15, 2010

### NIRI, SCSGP Issue Recs on Proxy Advisory Firm Oversight

As part of its broader look at “proxy plumbing” issues, the Securities and Exchange Commission should tighten oversight and increase disclosures by proxy advisory firms that influence the way many institutional investors vote their shares, some observers say.

A requirement for all proxy advisory firms to register as investment advisers is one of six recommendations detailed in a discussion paper published by the [National Investor Relations Institute](#) and the [Society of Corporate Secretaries & Governance Professionals](#) in advance of a [forthcoming SEC Concept Release](#) to look at proxy mechanics and voting issues. Currently, only three of seven proxy advisory firms are registered as investment advisers, the paper notes.

NIRI President and Chief Executive Jeff Morgan says a copy of the paper was sent to the SEC in hopes that the issues and recommendations “will be a part of the discussion” included in the concept release.



“From a company standpoint, the process is very opaque,” says Morgan. “Their processes need to be more out in the open.”

Despite their tremendous influence on institutional shareholder voting, proxy advisory firms “generally remain unregulated and unsupervised and often are not transparent with regard to their standards, procedures, methodologies, and conflicts of interest,” states the paper, “[Recommendations for Improving the Regulatory Oversight and Transparency of the Proxy Advisory Industry](#).”

Institutional investors and their third-party investment managers often lack in-house staff to analyze and vote on proxy items, and thus outsource voting decisions to proxy advisory firms. In many cases, they generally adopt the voting policies developed by one or more of the advisory firms, which the NIRI/SCSGP paper says may result in a “one-size-fits-all” approach rather than encouraging voting decisions on a case-by-case basis.

The groups say investors “may not be protected adequately because of the current deficiencies in regulatory oversight and transparency that exist within the proxy advisory industry.”

“Our members are concerned about the impact of these firms on voting and the fact that they seem to control a lot of institutional investor votes, as well as potential conflicts of interest and the lack of transparency,” says Darla

Stuckey, SCSGP senior vice president for policy and advocacy, who notes that the recommendations “speak for themselves.”

The paper says proxy advisory firms can “significantly influence” director elections and corporate actions since their mutual funds and pension plan clients often have huge stock holdings. NIRI and SCSGP say that influence will grow in light of the [change to New York Stock Exchange Rule 452](#), which they say will reduce the influence of retail investors.

“Unfortunately, several proxy advisory firms are not subject to any regulatory oversight, required disclosures, or fiduciary obligations regarding their ability to control or influence the outcome of shareholder votes at public companies in the United States,” the paper states.

In addition to increasing regulatory oversight of proxy advisory firms through the Investment Advisers Act of 1940, the groups say those firms should have to disclose conflicts of interest, such as relationships with any client who is the proponent of a proxy proposal or “vote no” campaign whenever the firm is issuing a recommendation to other clients in favor of the same proposal or “vote no” campaign.

Morgan says the SEC’s regulation of credit rating agencies is a “logical starting point” for developing a regulatory framework for proxy advisory firms.

NIRI and SCSGP also say proxy advisory firms should be required to publicly disclose their internal standards and methodologies, and their assumptions for developing voting recommendations and decisions.

They also suggest that the SEC and the Labor Department consider establishing a more robust due diligence process for institutional investors requiring them to exercise greater oversight responsibility for any delegation of their voting rights to a proxy advisory firm.

In addition, they recommend all proxy advisory firms be required to maintain a public record of all voting recommendations and decisions, and all institutional investors using proxy advisory services publicly disclose the actual proxy votes cast by them or on their behalf.

They also say public companies should have a chance to review proxy advisory firm draft reports for accuracy and to respond to comments or recommendations with which they disagree, and those responses should be disclosed by advisory firms to their clients.

Finally, they say proxy advisory firms should publicly and promptly disclose any errors made in executing or processing voting instructions on a particular proxy vote.

The paper was approved by the NIRI board and by the Policy Advisory Committee of SCSGP’s Board.

As [previously reported](#), the SEC has said issues to be addressed in the concept release include accuracy in vote tabulation, issues of “over-voting” and “empty voting,” low voting rates by retail investors, and possible changes to the beneficial owner distinction. Detailed Compliance Week coverage of possible OBO/NOBO reforms is available [here](#) (subscription required).

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