NACD NJ PROGRAM

OCTOBER 20, 2016

PROXY ADVISORS: THE UNVARNISHED TRUTH

On October 20, the Chapter hosted a distinguished panel comprised of the lead policymakers from both of the nation's leading proxy advisory firms (Bob McCormick, Chief Policy Officer of Glass, Lewis & Co., and Sean Quinn, Head of US research for ISS) and Glenn Booraem, Principal of the Vanguard Group, Inc., one of the nation's largest investment managers. The panel moderator was Keir Gumbs, partner in the Washington, DC office of Covington & Burling and former Special Counsel in the SEC's Division of Corporation Finance.

All panelists agreed that the motivation and processes the advisory firms use to produce their voting recommendations are a mystery to many investors, recommendations that can cover thousands of companies. Generally, proxy advisors do not "push an agenda", but rather formulate policy in reaction to the marketplace in a way that reflects the policies of their clients. Among the factors taken into account are regulatory developments, "hot" issues, feedback received directly from companies and their directors, and responses to surveys conducted by the NACD at the national level. Emerging issues of higher importance currently include proxy access, the use of total shareholder return as the central factor in setting executive compensation and the impact of long tenure on director independence, an issue now receiving much debate especially in Europe. Speakers from both firms praised the NACDs most recent Blue Ribbon Commission Report: Building the Strategic Asset Board, citing the Report's recommendation to move away from hard and fast rules on tenure and diversity and toward a focus on director skill sets that fit the company in real time. Policies on voting recommendations can easily be found on the firms' websites. Neither firm anticipates any significant change to its policies for the 2017 proxy season.

Disagreements between the firms on certain issues do arise, particularly in the areas of mergers and proxy contests. These result mainly from differences in methodology rather than differences in philosophy. Mr. Booraem stressed that only a small percentage of investors relies solely on the advisory firms. For example, Vanguard develops its own internal voting guidelines independently, looking to the advisory firms' recommendations only as additional input. When the firms disagree, Vanguard relies mostly on its own internal guidelines developed by its own staff. And due to a difference in philosophy, Vanguard sometimes may follow internal guidelines even when the internal recommendation may be at odds with both advisory firms', or may adopt the firms' recommendation but for an entirely different reason than the firms give. He further stressed that companies should establish regular lines of communication with major investors, provide data verification to minimize mistakes and not be hesitant to ask why the investor is prepared to vote a certain way. Investors need to make clear to companies what their own policies are apart from those of the advisory firms, via their websites or through direct communication with the issuer. The right contact at Vanguard on the issue of how it will vote would be the governance area that handles voting for all its funds, not the portfolio manager for the particular fund.

Vanguard is a leading manager of index funds and ETFs that don't actively trade. Sound voting decisions are important for those funds since they directly correlate to increased shareholder value. These funds care about that because they are locked into their investments due to their essential static nature.

Proxy advisory firms have sometimes been accused of having conflicts of interest in issuing their recommendations due to consulting arrangements they may have with issuers and others. Mr. McCormick stressed that Glass Lewis does not have a corporate consulting business and relies on full disclosure in "gray areas," such as where an issuer has a director interlock with the firm. Mr. Quinn stated that ISS does have a consulting business, but mitigates the appearance of conflicts through such techniques as maintaining separate reporting lines and formal communication barriers between departments.