

Testimony of Steven Friedman
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Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations

on

“Oversight of the Proxy Advisory Industry.”

July 13, 2023

Chairman Huizenga, Ranking Member Green, and distinguished members of the Subcommittee, thank you for the invitation to testify today on behalf of Institutional Shareholder Services (ISS).

My name is Steven Friedman, and I am the General Counsel of ISS. I have worked for ISS for nearly 20 years, having originally joined the company in September 2003 as its General Counsel, with a brief break in my tenure in the mid-2010s.

I hope my testimony today contributes to a constructive and fact-based discussion about proxy advisers by (1) explaining proxy advisers’ important, but limited, role in the proxy voting process; (2) describing how ISS is currently regulated in the United States and our responsibilities as a fiduciary to our institutional investor clients; and (3) conveying the facts about the work that ISS has been privileged to do in serving our institutional investor clients since our founding more than 35 years ago.

About ISS.

ISS was founded in 1985 in an era of aggressive corporate practices such as raiding, greenmail, and poison pills, when investors were seeking to more effectively exercise their rights as shareholders and their voice in corporate governance in a meaningful and informed way.

Today, ISS is a leading provider of corporate governance and investment research, data, and analytics to financial market participants around the globe. As part of our core offerings, ISS provides institutional investors with objective, timely, and expert proxy research and vote recommendations based on the proxy voting policies selected, and in many cases, customized, by our institutional investor clients.¹ We do not serve retail investors directly.

ISS takes pride in having grown our business by virtue of the quality of our work and the level of client service we provide. We perform our work in a prudent, open, and honest manner, consistent with our fiduciary responsibilities as an investment adviser registered with the U.S. Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940 (Advisers Act).

While ISS is proud of our work in assisting our institutional investor clients regarding the proxy voting process, I must emphasize that our role is limited. It is the *client* who creates or selects the proxy voting policies and guidelines that reflect their own fiduciary obligations and investment priorities. Our job is to synthesize data, analyze proxy statements, and formulate vote recommendations that flow from the client's chosen policies and guidelines. The client decides whether or not to follow our vote recommendations, or to refrain from voting altogether.

In many cases, our institutional investor clients develop custom voting policies that reflect their individual investment objectives and strategies and their own approaches to capital stewardship. During calendar year 2022, approximately 86% of the total voted shares processed by ISS on behalf of our clients were linked to clients' custom voting policies.

For clients who choose not to use a custom policy, ISS offers a range of proxy voting policy options, starting with a Benchmark Voting Policy designed to reflect current market sentiment regarding long-term shareholder value, good governance, and risk mitigation. ISS also offers Specialty Voting Policies that evaluate voting issues from a range of perspectives, including faith-based investing, sustainability, socially

¹ In 2022, ISS helped more than 1,600 governance research and voting clients make and execute proxy voting decisions for approximately 50,000 shareholder meetings in over 110 developed and emerging markets worldwide.

responsible investing, public funds and labor unions. Another Specialty Voting Policy is largely aligned with the recommendations of corporate boards. By offering this range of options, ISS empowers clients to exercise their rights as shareholders in accordance with their own investment parameters and risk-return assessments.

ISS employs a variety of robust procedures designed to ensure that our proxy voting advice is objective and independent and, above all, that it aligns with clients' stated needs and preferences. For example, to promote transparency, accountability, and accuracy, ISS uses only publicly available corporate reporting to analyze the terms of proposals presented to shareholders for a vote. In addition, ISS maintains a Data Verification Portal that allows U.S. issuers to verify more than 400 governance and compensation datapoints used in our analyses. ISS has implemented a comprehensive compliance program and a Code of Ethics,² which devotes special attention to mitigating conflicts of interest, including potential conflicts between ISS' research teams and our affiliate's work on behalf of corporate issuers.

ISS is also committed to transparency. In addition to making our proprietary voting policies available on our public website,³ ISS conducts a comprehensive annual policy review process to help ensure that the voting policy guidelines are updated as necessary to reflect the views of investors and other market participants regarding good governance practices, relevant regulatory changes, and practical implementation matters. Our Benchmark Voting Policy review and update process is robust, inclusive, and transparent; it is open to investors, companies, and the general public. The Specialty Voting Policies, too, reflect investor and market input in addition to incorporating feedback gathered during the annual review and update of the Benchmark Voting Policy. Furthermore, we periodically develop additional specialty policies in response to client demand for voting recommendations that reflect other, distinct investment priorities and perspectives.

² The Code of Ethics is available on the ISS website at [code-ethics-nov-2022.pdf \(issgovernance.com\)](#) and is described in ISS' regulatory disclosure brochure (Form ADV), which is available on the SEC website at [crd_iapd_Brochure.aspx \(sec.gov\)](#).

³ See [ISS Policy Gateway \(issgovernance.com\)](#).

Market demand for proxy advisory services.

As was the case at our founding in 1985, proxy advisers are a market-based solution for institutional investors looking for an efficient and cost-effective way to aggregate, synthesize, and analyze the relevant data and information for the thousands of ballot items considered at shareholder meetings of their portfolio companies each proxy season. Institutional investors purchase our services because they see value in the analyses and vote recommendations we provide.

But it is important to note that institutional investors are not required to use the services of proxy advisory firms, and many choose not to, either because they perform the functions in-house or because they do not vote proxies for their clients. In our experience, institutional investors who do choose to use the research and recommendations of one or more proxy advisory firms consider this information to varying degrees, alongside their own in-house research and the views of management, shareholder proponents, and other investors. Investors may also directly engage with their portfolio companies on a variety of matters and take this engagement into account in deciding how to vote, consistent with their own fiduciary duties and in a manner that best advances the interests of their own clients.

It is also important to note that ISS and other proxy advisory firms operate in a free market. There are no artificial barriers to new proxy advisory firms entering the market. Over the years, ISS has seen market forces at work and entrants come and go, including, most recently, the launch of a new proxy advisory service by a self-described “anti-ESG” asset management firm.

Institutional investors control their own proxy votes.

Many institutional investors buy proxy research and review proxy advisers’ analyses and recommendations but vote according to their own individually designed proxy voting guidelines, developed in consultation with their governance departments, boards of trustees, and portfolio managers. These guidelines may also factor in certain financial elements, such as investment time horizons and risk tolerance, which vary by investor. The proxy voting guidelines set criteria to be used in determining how the investor casts its proxy votes, including

identifying matters for investors' case-by-case analysis (e.g., proposed mergers, contested director elections, or certain shareholder proposals).

As noted before, during calendar year 2022, approximately 86% of the total voted shares processed by ISS on behalf of our clients were linked to clients' custom voting policies. This means that, for the vast majority of shares, it is the clients' *custom voting policies*, which reflect their mandates and specific proxy voting considerations, that set the basis for and direct ISS' vote recommendations. Thus, clients' preferences are baked into the vote recommendations ISS makes and are derived directly from investors' own proxy voting guidelines.

ISS is indifferent as to whether clients follow an ISS vote recommendation or not – or indeed, whether they choose to vote at all. It is the institutional investors who are responsible for both their voting policy selections and voting decisions on behalf of their own clients and beneficiaries.

You do not have to take our word for it. Institutional investors have clearly and consistently confirmed how proxy advisers help them to make voting decisions that align with investors' own preferences, objectives, and interests.

- For example, the Council of Institutional Investors (CII), a leading nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, and state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion, has observed:

Proxy advisory firm influence is exaggerated by analyses that confuse correlation with causation. ISS and Glass Lewis tend to follow investors on governance policy, not lead them. In setting their policy frameworks, the two firms have a business interest to ensure they reflect investor (client) perspectives, in part through extensive consultative processes, and to consider empirical evidence. Their franchises are built on credibility with investors. As a result, advisors' views reflect those of many funds. Indeed, if there were a sharp divergence, we would expect to see advisors punished in the marketplace.⁴

⁴ Letter from the Council of Institutional Investors (CII) to Rep. Hensarling, Chair of House Committee on Financial Services (Jun. 13, 2016) at 2.

- Institutional investors expressed the same views in connection with the 2018 SEC Roundtable on the Proxy Process (2018 Roundtable), where the Corporate Governance Officer of the Ohio Public Employees Retirement System (OPERS) said:

It's our fiduciary responsibility to vote proxies in [Ohio public employees' and retirees'] best interests, which means increasing shareholder returns. The way that we're able to do that is by partnering with a proxy advisory firm. We have our own corporate governance policy and guidelines, and we contract with a proxy advisory firm for two services: for their voting platform. . . and then also for research. But it's our guidelines and policy that drive how our votes are cast.⁵

- In fact, some of our self-identified custom policy clients have gone so far as to characterize our vote recommendations as “irrelevant” to their proxy voting decisions.⁶

Academic studies confirm this first-person testimony. For example, the well-known, independent Fisch, Choi, Kahan study concluded, “. . .ISS is not so much a Pied Piper followed blindly by institutional investors

⁵ Remarks of Patti Brammer, Transcript of the 2018 Roundtable on the Proxy Process at 187, (Nov. 15, 2018) *available at* <https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf>, (2018 Roundtable Transcript). *See also* remarks of Jonathan Bailey, Managing Director and Head of ESG Investing, Neuberger Berman, LLC, *id.* at 184 (noting that his firm relies on proxy advisers to “execute the work for our management around how those proxies are voted” and for data aggregation. “A standardized form of pulling data together around certain elements of the proxy [is] very helpful for us in executing our own independent policy.”); and the following public comments submitted to the SEC in connection with the 2018 Roundtable, *available at* <https://www.sec.gov/comments/4-725/4-725.htm>: letter from Kurt N. Schacht, Managing Director, CFA Institute (Oct. 4, 2019) at 2 (institutional investors “hire proxy advisers to act as consultants and analysts with regard to sorting through hundreds or thousands of company proxy statements. . . . Investors know not to rely solely on a single analyst’s recommendation when buying or selling a security. In a similar manner, they employ multiple inputs into investment and proxy decision-making.”).

Institutional investors also expressed the same views in response to the SEC’s request for comment on the 2020 proxy advisory rules, SEC Rel. No. 34-87457 (Nov. 5, 2019), *available at* <https://www.sec.gov/comments/s7-22-19/s72219.htm>: Letter from Paul Schott Stevens, President and CEO, Investment Company Institute (Feb. 3, 2020) at 3 (“[F]und advisers that consult [proxy advisers’] research and recommendations may consider this information to varying degrees, along with views of companies, other investors, and shareholder proponents. Given the complexity and range of fund proxy voting responsibilities, many fund complexes value [proxy advisers’] services.”); letter from Lisa A. Smith, Vice President, Advocacy and Public Policy, Catholic Health Association of the United States (Feb. 3, 2020) at 2-3 (“Proxy advisory firms are a cost-effective part of the shareholder voting process. . . .Proxy firms merely offer advisory recommendations, no institutional investor is required to follow them.”).

⁶ *See* Proxy Process and Rules: Examining Current Practices and Potential Changes: Hearing Before the Committee on Banking, Housing, and Urban Affairs, S. HRG. 115–455, Statement of Michael Garland, Assistant Comptroller for Corporate Governance and Responsible Investment in the Office of New York City Comptroller (Dec. 6, 2018) (“Like other institutional investors with custom policies, we use the research we receive from both of our proxy advisors as a critical inputs [*sic*] into how we apply our own guidelines. The specific proxy voting recommendations from the proxy advisors are entirely irrelevant to our process.”).

as it is an information agent and guide, helping investors to identify voting decisions that are consistent with their existing preferences.”⁷

ISS is a federally regulated investment adviser.

Proxy voting advice is a form of investment advice. Therefore, as indicated earlier, ISS is a Registered Investment Adviser (RIA) under the Advisers Act. This statute and related SEC rules provide a mature and comprehensive regulatory regime that covers virtually every aspect of our business and that effectively addresses transparency, accountability, accuracy, and conflict mitigation in the proxy advisory system.

As an RIA, ISS is subject to the Advisers Act’s fiduciary duties of care and loyalty, which follow the contours of ISS’ contractual relationship with our clients. The fiduciary duty of care obliges ISS to render advice that is in the clients’ best interest. The duty of loyalty obliges ISS not to subordinate clients’ interests to its own. This entails an obligation to "eliminate or at least expose through full and fair disclosure all conflicts of interest which might incline [the] investment adviser — consciously or unconsciously — to render advice [that is] not disinterested.”⁸

ISS takes these duties seriously and is extremely proud of the fiduciary bond we have forged with our clients over the years.

How ISS discharges its responsibilities under the Advisers Act.

Because ISS’ fiduciary duties follow the contours of its relationship with its clients, it is important to understand what those relationships do and do not entail. ISS does not choose the ballots or agenda items on which it renders advice. ISS provides its services only to clients who have hired it to do so, and then it

⁷ Choi, Stephen J., Fisch, Jill E. and Kahan, Marcel, *The Power of Proxy Advisors: Myth or Reality?* 59 Emory L. J. 869 (2010); University of Pennsylvania, Institute for Law & Economics Research Paper No. 10-24. *available at* SSRN: <http://ssrn.com/abstract=1694535>.

⁸ SEC, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Rel. No. 5248 (Jun. 5, 2019) at 23, *citing* *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963).

analyzes only the companies and issues designated by its clients in accordance with the voting policies and guidelines they have selected.

ISS' clientele is not monolithic. Investors have different investment objectives, risk tolerances, and time horizons. Even where investors' ultimate objectives are the same, the investment strategies they pursue to achieve those objectives often differ. And even when they pursue the same investment strategy, investors often have different views on the relevance of specific information to their risk-return analyses and different ways of assessing how proxy voting serves their investment goals. This includes whether certain environmental, social, or governance factors may affect financial returns and how such considerations align with their underlying clients' goals and mandates. This diverse mix of investment approaches makes our capital markets robust.

ISS respects our clients' diversity of opinions and does not take a one-size-fits-all approach to our proxy voting advice. Nor do we dictate our clients' investment objectives, investment strategies, or how they assess the relevance of specific information, including ESG considerations, to their objectives and strategies. Instead, ISS accompanies each vote recommendation with a comprehensive report, synthesizing available information in a manner that permits the institutional investor to assess the recommendation's impact and alignment with the investor's particular voting policy.

Given the number of custom voting policies and the variety of ISS proxy voting policies clients select, ISS can make opposing recommendations to different clients on the same ballot issue. In some instances, ISS may even offer different recommendations about the same vote to the *same* client if that client has selected more than one set of voting criteria in response to the varying objectives of its own clients. ISS is indifferent regarding the outcome of a proxy vote. We do not have a stake in, and do not solicit votes for, the passage or defeat of any ballot measure.

Institutional investors' proxy voting responsibilities and duty to oversee their proxy advisers.

The voting decision for each resolution at a company meeting - whether or not supported by the services of a proxy adviser - is the responsibility of the company's shareholders or their designated voting agents, such as investment managers or pension plan trustees.

The regulatory regimes established under both the Advisers Act and the Employee Retirement Income Security Act of 1974 (ERISA) address the engagement of proxy advisory firms by fiduciaries who vote proxies on investors' behalf. Under each regime, fiduciaries are not relieved of their duty to act loyally and in their clients' best interest simply because they have hired a proxy advisory firm to make vote recommendations. On the contrary, a fiduciary that engages a proxy adviser is obliged to conduct initial and ongoing due diligence on that adviser and to determine that such firm's guidelines and recommendations are consistent with the fiduciary's duties to its investor clients.⁹

In our experience, investors take their obligations seriously and engage with us regularly in conducting due diligence of ISS as a service provider.

Factual accuracy of proxy advisory reports.

ISS' business model depends on factual accuracy. Our incentives are to ensure that our investor clients have access to accurate information, and thus these incentives align with those of both institutional investors and issuers alike. ISS' record of accuracy is one of which we are proud.

In saying this, we observe that most allegations of a proxy adviser's "errors" are made by the subjects of the reports and appear to be analytical or philosophical disagreements on issues, such as what are the relevant company peer comparisons for review of executive compensation, what number constitutes too many board memberships for any individual director (so called "overboarding"), or whether the roles of CEO and Board

⁹ SEC, *Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, Advisers Act Rel. No. 5325 (Aug. 21, 2019), 84 Fed. Reg. 47420 (Sep. 10, 2019), available at <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>; ERISA Investment Duties Regulation, 29 CFR § 2550.404a-1(d)(2)(ii)(E) and (d)(2)(iii).

Chair should be held by different individuals. Our sophisticated institutional investor clients understand these philosophical differences and they have been very vocal on the issue of proxy advice accuracy, as the following comments on the SEC’s 2020 rulemaking demonstrate:

- “Concerns about errors in proxy reports are not shared by [the Colorado Public Employees’ Retirement Association (“PERA”)]. In the 30 years that we have contracted with proxy advisors, we have not known of any material issues with, or errors in, the proxy reports and analysis. Additionally, PERA has never been approached by an issuer to discuss what they perceived as material issues in a proxy advisor’s report.”¹⁰
- “In the course of our engagements with company management and board members, [Florida State Board of Administration (SBA)] staff has often heard about purported “errors” in the advisory reports, and yet we have not encountered a single error that was either significant in its impact or one that would have changed our vote outcome.”¹¹
- “It is our [T. Rowe Price] informed belief, based on years of experience working with proxy advisory firms as both an issuer and an institutional investor, that proxy advisors do not need oversight by issuers in order to provide accurate research reports.”¹²
- CFA Institute: “Based on several estimates, the mistakes are a tiny fraction of annual proxy issues voted. Moreover, the quality of proxy advice has never been higher.”¹³

A 2016 GAO report similarly concluded, “Both corporate issuers and institutional investors [the GAO] interviewed said that the data errors they found in the proxy reports were mostly minor....”¹⁴

Calls for “reform” of the proxy advisory system are unfounded.

A variety of false assertions and urban legends have led to calls to “reform” proxy advisers, with those calls almost uniformly coming from the companies we review, not the institutional investors we serve. In the free market, year after year, investors turn to us for support because we provide a cost-effective means to

¹⁰ Letter from Ron Baker, Executive Director, Colorado Public Employees’ Retirement Association (Feb. 3, 2020) at 7. This and the following comments are *available at*: [SEC.gov/Comments on Proposed Rule: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice](https://www.sec.gov/Comments/ProposedRule/Amendments-to-Exemptions-from-the-Proxy-Rules-for-Proxy-Voting-Advice).

¹¹ Letter from Ashbel C. Williams, Executive Director & CIO, Florida State Board of Administration (Feb. 3, 2020) at 3-4.

¹² Letter from William J. Stromberg, President and CEO, T. Rowe Price (Jan. 29, 2020) at 1.

¹³ Letter from James Allen, Head, and Matt Orsagh, Senior Director; Capital Markets Policy, CFA Institute (Feb. 3) at 6.

¹⁴ U.S. Gov’t. Accountability Office, *GAO-17-47, CORPORATE SHAREHOLDER MEETINGS, Proxy Advisory Firms’ Role in Voting and Corporate Governance Practices*, 29 (2016).

aggregate data and access high-quality, timely, and independent research and recommendations in line with investors' selected proxy voting policies.

Such "reform" proposals generally seek to reorient the proxy adviser-client relationship away from the fiduciary relationship under the Advisers Act to make proxy advisers accountable to corporate issuers, the subjects of their research and vote recommendations, either directly through mandatory pre-clearance of proxy advisers' reports with company executives or indirectly by raising proxy advisers' liability or litigation risks. Such proposals fundamentally ignore the fact that proxy advisers are agents of institutional investors, not of issuers. These proposals seek to "cure" alleged concerns with proxy advisers, despite investors' overwhelming objections and despite the potential conflicts concepts such as mandatory issuer draft review would introduce into the proxy research process.

We continue to believe, as the SEC's Office of Investor Advocate stated,¹⁵ that safeguarding the independence, quality, affordability, and timeliness of proxy analysis and advice is critical to investors and that investors should have unencumbered access to the advisers and research they need to fulfill their fiduciary responsibilities.

Thank you again for the opportunity to testify today and I welcome your questions.

¹⁵ SEC, Office of Investor Advocate, Report on Activities for FY 2020 (Dec. 29, 2020) at 5, *available at*: <https://www.sec.gov/files/sec-investor-advocate-report-activities-2020.pdf>.