

December 7, 2018

Senate Committee Holds Hearing
on Proxy Voting Process

Yesterday the U.S. Senate Committee on Banking, Housing and Urban Affairs held a full committee hearing on the proxy voting system. The three key topics were the role of proxy advisory firms, the shareholder proposal process, and retail shareholder participation. These topics were recently addressed at the SEC roundtable on the proxy process.

In his opening statement, [Chairman Mike Crapo](#) focused on the financial interests of retail investors. Noting unprecedented levels of concentration and intermediation in the public capital markets, Senator Crapo emphasized the importance of having “the proxy voting process and voting decision of fiduciaries reflect the clear economic interests of the retail investors on whose behalf these institutional investors engage.” [Ranking Member Sherrod Brown](#) took aim at “corporate mismanagement and abuse” in his opening statement. He suggested that the research and analysis provided by proxy advisory firms are valuable tools for institutional investors to use as they attempt to “hold executives accountable” and expressed concern that some recently proposed proxy process reforms would make it more difficult for shareholders to oversee the companies they own.

The Committee heard testimony from three witnesses. Former [SEC Commissioner Daniel Gallagher](#) reviewed the regulatory and legislative developments that led to the unanticipated rise of proxy advisory firms and the current circumstances in which proxy advisors wield “outsized influence” without having to demonstrate how or whether their voting recommendations increase shareholder value. Mr. Gallagher endorsed reforms that recognize and address the unhealthy systemic dependence on proxy advisory firms and facilitate the development of “a balanced system that efficiently and effectively furthers the interests and needs of shareholders, their investment advisers, and the public companies in which they invest.” Regarding the shareholder proposal process, Mr. Gallagher cited data indicating that “the vast majority of proposals are brought by individuals or institutions with idiosyncratic and sometimes political agendas,” noted that shareholders bear the costs of companies addressing those proposals and highlighted several previously proposed reforms to Rule 14a-8.

[Michael Garland](#), from the Office of the New York City Comptroller, emphasized the NYC Pension Funds’ focus on “long-term, sustainable value” and

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stated that environmental, social and governance factors have been positively linked to risk management and long-term value creation. He described proxy advisory firms as “indispensable,” citing their research reports and their independent analysis as positive additions to the NYC Funds’ proxy voting process. He cautioned against reforms that would add to the burdens faced by funds as they vote proxies each year. With respect to shareholder proposals, Mr. Garland pointed out that the NYC Funds have filed more than one thousand proposals over thirty years. He expressed the view that, in its current form, “the shareowner proposal process is an essential and cost-effective tool for investors to protect and enhance value.”

[Thomas Quaadman](#), of the U.S. Chamber of Commerce, advocated for increased oversight of proxy advisory firms. In particular, he recommended that the SEC take action to reduce proxy advisors’ conflicts of interest and to enhance the conditions that a proxy advisory firm must satisfy in order to be exempt from the proxy solicitation rules. Mr. Quaadman also recommended reforms to the shareholder proposal process that would tighten the connection between proposals and the economic interests of shareholders, including raising the resubmission thresholds and ensuring transparency regarding the proponents’ identities.

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The role of proxy advisory firms is receiving needed scrutiny. While it remains to be seen whether legislative or regulatory reform will be implemented in the near term, it is clear that momentum is building in that direction. In June, this Committee heard testimony regarding [proposed legislation](#) that would increase the transparency and accountability of proxy advisory firms, and a [bipartisan Senate bill](#) was recently introduced that would regulate such firms.

While there was significant disagreement among the witnesses as to the desirability of reforms to Rule 14a-8 and as to the effect of client-directed voting, there seemed to be a consensus that if meaningful, cost-effective participation by retail investors in the proxy process can be increased—likely facilitated through technological advancements—that would be beneficial.

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