Report on Proxy Advisors – the Empirical Evidence

The Realities of Stewardship

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Overview

- Existing research on proxy advisors (mine and others)
- Correlation or causation?
- The market for advisory services

What do proxy advisors do?

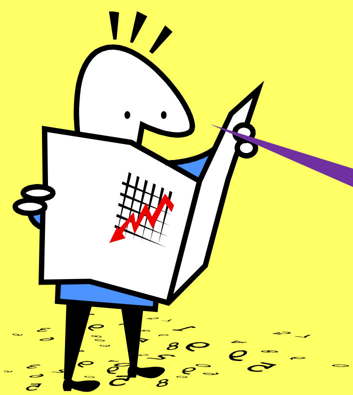
- Issue a report and recommendation in connection with shareholder voting
- Operate on a subscription basis serving institutional investors
- Coverage continues to increase
  - ISS covers 40,000 meetings worldwide
  - Issues recommendations and reports for 10,000 US issuers
  - 3300 clients (institutional investors and issuers)

What do they do?

- They also
  - Provide voting services
  - Assist institutions in formulating voting policies
  - Advise issuers on corporate governance

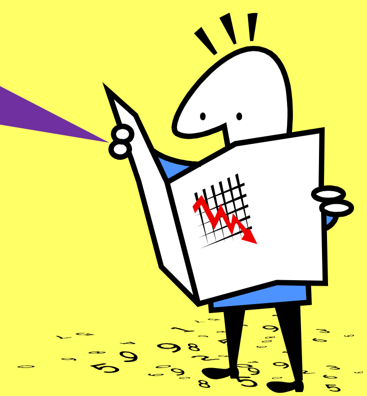
Why do we care about them?

- Shareholder voting has become increasingly important



ISS wields "tremendous clout"

ISS sways up to 30% of the vote



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The Bottom Line

- ISS recommendation is a significant predictor of voting outcomes
- Choi, Fisch & Kahan (2010) (2005 & 2006 uncontested director elections)
  - Unadjusted "effect" of ISS: 20%
  - Multivariate regression controlling for approximately 21 firm-specific factors
  - Effect of ISS after controlling for other factors: 6-10%
- Why uncontested elections?
  - Information intense, not event driven, reflective of ongoing governance oversight

Similar effect on other votes - shareholder proposals

- Cotter, Palmiter & Thomas (2010) (shareholder and management proposals - 2003-2008)
- Mutual funds followed ISS more often than other shareholders
- When ISS and management agreed, stockholders followed that recommendation more than 90% of the time.

Similar effect on other votes - Say on pay

- Ferri & Oesch (2012 working paper)
- Proxy advisor recommendations are the “key determinant of voting outcome”
- Negative ISS (GL) recommendations are associated with 24.7% (12.9%) more votes against the compensation plan
- When both recommend *Against*, voting dissent is higher by 38.3%.

Similar effect on other votes - Mergers

- Davidoff, Fisch & Griffith (2013 working paper)
- Completed 2005-2012 mergers with transaction value > $100 million
- ISS *for* recommendation correlates with approximately 8-9% more votes in favor
- The median percentage of *yes* votes as a percentage of all votes cast is 84.81% for a *no* recommendation compared to 99.55% for a *yes* recommendation

Causation or Correlation

- No question that ISS recommendations (as well as those of other proxy advisors, to a lesser degree) are correlated with voting outcome
- But only a small percentage of investors delegate voting decisions to ISS (following ISS blindly)
- These tend primarily to be smaller institutional investors

Do Funds Follow ISS Blindly?
from Choi, Fisch & Kahan (2013)

Fund Voting and ISS Recommendations

	Assets ($ millions)	% Assets in sample
Fund Votes that Follow ISS >.99	76,632	3.04%
Fund Votes that Follow ISS > .975	255,874	10.16%
Fund Votes that Follow ISS > .95	478,701	19.00%
Fund WH cond. on ISS WH rec. > .9	80,664	3.20%
Fund WH cond. on ISS WH rec. > .8	203,345	8.07%
Fund WH cond. on ISS WH rec. > .7	208,719	8.28%
Fund WH follow ISS/tot. Fund WH > .9	177,764	7.06%
Fund WH follow ISS/tot. Fund WH > .8	334,244	13.27%
For comparison: Rel. WH < 0.1:		

Funds that follow ISS with respect to more that 99% of all ISS

Blindly following ISS is less common than blindly following board

recommendations account for only 10% of the sample assets.

Management Recommendations matter too

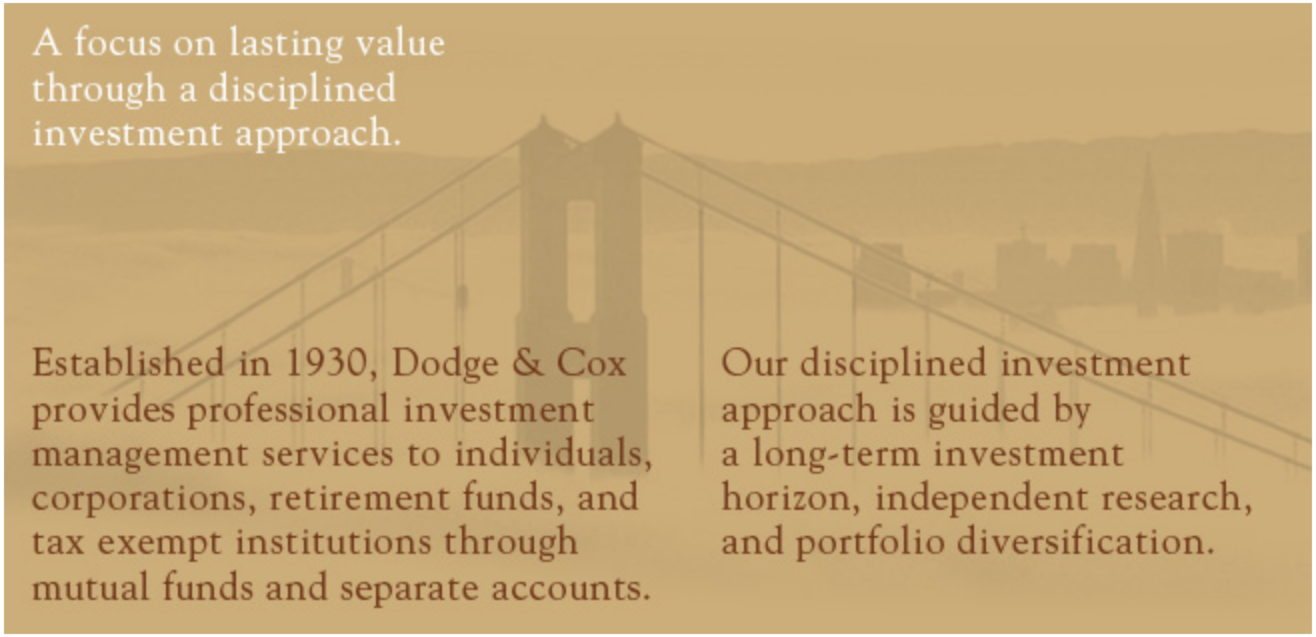
- Choi, Fisch & Kahan (2013) (To the extent they use a short-cut, investors are more likely to follow management blindly than to follow ISS blindly)
- Cotter, Palmiter & Thomas (mutual funds follow ISS more than other shareholders)
- Both prior to elimination of broker discretionary voting

Do Funds Follow ISS?

- Vanguard rejected (60%) of ISS’s withhold recommendations and 76% of Vanguard’s withhold votes were cast on directors for which ISS recommended a “for” vote.

Do Funds Follow ISS?

- Dodge & Cox (5th largest fund family in sample
- Zero withhold votes



Why are the correlations so high?

- ISS formulates its policies based on customer preferences

ISS description of policy development process

- Policy survey
- Global outreach
- Survey results released
- Comment period
- Final policy updates released

Cotter, Palmiter & Thomas (2010)

- Mutual funds follow ISS more on particular proposal types such as declassifying board and adopting majority voting
- These are the issues where institutions have taken the lead, often sponsoring as well as supporting
- Supposedly “independent” institutions vote similarly

Why are the correlations so high?

- ISS formulates its policies based on customer preferences
- ISS flags issues for shareholder attention

Do Funds Follow ISS?
from Choi, Fisch & Kahan (2013)

ISS Recommendations
For: 93.2%
Withhold: 6.8%

	Average	**Asset-weighted**
Fund For/ISS For	94%	95.6%
Fund Withhold/ISS Withhold	47%	26.5%

Withhold recommendations matter more!

Why are the correlations so high?

- ISS formulates its policies based on customer preferences
- ISS flags issues for shareholder attention
- ISS provides information specifically tailored to its voting policies
  - See Ertimur, Ferri & Maber (2012) on options backdating and withhold votes

What explains high withhold votes? ISS only goes so far

from Choi, Fisch & Kahan (2013)

Probability of high withhold vote

	ISS withhold only	**ISS withhold plus one of four factors**
Withhold vote > 30%	21%	48%
Withhold vote > 40%	7%	19%
Withhold vote > 50%	.5%	5%

The Four Factors Are:

Fidelity withhold vote
Attendance at less than 75% of board meetings
Ignoring a shareholder resolution that received majority support
Vanguard withhold vote on outside linked director

Some Thoughts on the Market for Advisory Services

- Competition and the market for proxy advice
- Transparency
- Conflicts of Interest
- The maturation of the market

All proxy advice is not the same

- Choi, Fisch & Kahan (2009) (differing withhold recommendations by then-four major firms (ISS, Glass Lewis, Proxy Governance, Egan Jones)
- Ferri & Oesch (Glass Lewis issued almost twice as many *no* recommendations on executive compensation as ISS)

But market discipline is limited

- Investors need a low cost comprehensive source of proxy information
- Hard to measure (or even conceptualize) quality

Some studies are attempting to measure the relationship between ISS recommendations and outcome/performance variables, but these studies are preliminary and present challenges. See, e.g., Larcker, McCall & Ormazabal (working paper 2012) ("proxy advisory firm recommendations regarding stock option repricings are *not* value increasing for shareholders")

Proxy Advisors and Transparency

- The pros and cons of one-size-fits-all
  - A uniform approach prevents less-transparent advisor discretion
  - A uniform approach reduces costs
  - But the same approach may not be right at all issuers
- ISS 2013-14 policy guidelines announce a greater emphasis on case-specific analysis

Proxy advisor transparency

- Policy development process (described earlier)
- Increasing disclosure of underlying methodology – See, e.g., Evaluating Pay for Performance Alignment *ISS' Quantitative and Qualitative Approach* Published December 2012 Revised: January 2013

Conflicts – Real or Imagined

- At least with respect to ISS, its "good governance" metric is fairly well known
- Possible value of disclosing in the report whether an issuer purchases advisory services
- Given widespread use of ISS by investors, disclosure of proponent's customer status is of questionable value

Maturation of the market for advisory services

- We haven't been doing this very long –
  - SEC mandated mutual fund voting disclosure – 2003
  - NYSE eliminated broker discretionary voting
    - For uncontested director elections - 2010
    - For non-routine shareholder proposals - 2012
  - Dodd-Frank mandates say on pay - 2011
- Most limitations of proxy advisors result from uncertainty or disagreement about "best" governance practices

Thank you!