STANFORD CLOSER LOOK SERIES

SEVEN QUESTIONS ABOUT PROXY ADVISORS

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INTRODUCTION

The proxy advisory industry—in which independent third-party firms provide voting recommendations to institutional investors for matters on the annual proxy—has grown in size and controversy. Despite a large number of smaller players, the proxy advisory industry is essentially a duopoly with Institutional Shareholder Services (ISS) and Glass Lewis controlling almost the entire market.[1]

The recommendations of these firms are prominent, especially in matters such as contested director elections, the approval of large pay packages, corporate takeovers, and other closely contended issues. Nevertheless, the degree to which these firms *influence* voting outcomes and corporate choices is not established, nor is the role they play in the market. Are proxy advisory firms information intermediaries (that digest and distill proxy data), issue spotters (that highlight matters deserving closer scrutiny), or standard setters (that influence corporate choices through their guidelines and models)? Because of the uncertainty around these questions, disagreement exists whether their influence is beneficial, benign, or harmful. Defenders of proxy advisors tout them as advocates for shareholder democracy, while detractors fashion them as unaccountable standard setters.

The tension has played out on the regulatory front with the Securities and Exchange Commission (SEC) subjecting proxy advisory firms to heightened standards in 2019 only to decline to enforce those standards two years later.[2]

In this Closer Look, we examine seven important questions about the role, influence and effectiveness of proxy advisory firms.

QUESTION #1: WHAT IS THE MARKET ROLE FOR PROXY ADVISORS?

Proxy advisory firms sell recommendations to institutional investors on their view of how to vote proxy proposals across thousands of companies.[3] ISS describes its recommendations as "independent and objective shareholder meeting research and recommendations… to help [institutional investors] make informed investment stewardship decisions, and to help them manage their voting responsibilities."[4] Glass Lewis describes itself as "a trusted ally of more than 1,300 investors globally who use our high-quality, unbiased [research] … to help drive value across all their governance activities."[5] These descriptions are consistent with a role as *information intermediaries*, with proxy firms offering the benefit of economies of scale to aggregate and analyze information that would be costly for individual investment firms to replicate on their own. Iliev and Vitanova (2023) arrive at this depiction in their analysis of voting recommendations.[6]

A second and related idea is that proxy advisory firms are *issue spotters*. In this description, the value of proxy advice comes from sifting through thousands of issues to identify those that require additional attention and analysis—which the investment firm itself then conducts. Sarro (2021) argues that this is the real role that proxy advisors play, concluding, "[Their] influence derives primarily from their ability to direct institutional investors' attention away from some proposals and toward others."[7]

Another theory is that proxy firms are *controversy creators*. Closely contested proxy matters are beneficial to the proxy advisory firm because close contests increase the economic value of a proxy advisor's recommendation. (In this way, proxy advisory firms do not have the same economic interests as those of investment advisors.) Malenko, Malenko, and Spatt (2023) argue that proxy advisory firms benefit from "biasing" recommendations (their word) to increase the frequency of close votes in order to increase demand for their services.[8,9]

Another theory is that proxy advisors are *agenda setters*. Through survey data, Hayne and Vance (2019) demonstrate that boards feel pressure to alter their governance practices to conform to the standards of proxy advisory firms, despite a preference for alternative structures (see Exhibit 1). They conclude that proxy advisors are not merely information intermediaries but agenda setters because the one-size-fits-all nature of their voting

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guidelines compels conformity among corporate practices.[10]

Currently, we do not have consensus about the role or roles that proxy advisory firms play.

QUESTION #2: HOW DO PROXY ADVISORS DERIVE THEIR INFLUENCE?

Proxy advisor recommendations influence voting outcomes. The degree of influence, however, is not established. Brav, Cain, and Zytnick (2022) show that institutional investors are highly sensitive to an opposing recommendation from proxy advisory firms, with opposition from ISS associated with a 51 percent difference in institutional voting support compared with only a 2 percent difference among retail investors.[11] Malenko and Shen (2016) estimate a negative recommendation from ISS leads to a 25 percentage point reduction in voting support for say-on-pay proposals.[12] Data from Copland, Larcker, and Tayan (2018) show a negative recommendation from ISS is associated with a 17 percentage point reduction in support for equity-plan proposals, 18 points for uncontested director elections, and 27 points for say on pay.[13] Rose (2021) examines "robo-voting"—the practice of fund managers voting in lock-step with the recommendations of ISS (defined as 99.5 percent alignment). He identifies 114 institutions managing $5 trillion in assets that robo-vote (see Exhibit 2).[14] Iliev and Lowry (2015) find that 25 percent of institutional investors vote "indiscriminately" with ISS (see Exhibit 3).[15]

What is unknown is whether the influence proxy advisory firms exert on voting practices is evidence of the value of their services (i.e., the quality of their recommendations) or distortions caused by the regulatory environment. Generally, firms purchase services because of the value vendors provide, and it might be the case that institutional investors purchase voting recommendations from ISS and Glass Lewis because they are a cost-effective means of making informed voting decisions.

On the other hand, it might be that economic demand for voting recommendations is artificially inflated by the regulatory environment. The SEC requires institutional investors to vote all matters on the proxy and to make their votes public.[16] To satisfy this obligation, institutional investors must develop proprietary guidelines or rely on guidelines developed by third parties.[17] Firms whose voting patterns are closely correlated with ISS or Glass Lewis recommendations apparently have elected to rely extensively on these guidelines. Whether they do so because they find these guidelines value-enhancing to their shareholders or an inexpensive way of meeting a regulatory requirement to vote is uncertain.

QUESTION #3: HOW DO PROXY ADVISORY FIRMS TEST THE VALIDITY OF THEIR RECOMMENDATIONS?

Because institutional investors rely on proxy voting guidelines to inform their voting decisions, it is important that proxy advisory firms test their standards through a rigorous analytical process to ensure accuracy.

We do not have detailed information about how policy guidelines are developed. ISS discloses some information about how it updates policies; Glass Lewis does not disclose this information.[18] The ISS annual update cycle includes the following steps:

- Internal review of emerging issues, regulatory changes, and trends
- Review of academic literature, empirical studies, and market commentary
- Survey of and roundtable discussion with investors and corporate issuers
- Release of draft policy updates
- Open review and comment period
- Release of final policy updates[19]

We do not know whether, as part of this process, ISS tests existing guidelines through empirical analysis to ensure they are associated with positive outcomes, such as increased operating- or stock-price performance or a lower incidence of governance failures (such as restatements, regulatory violations, lawsuits, or bankruptcy). Without empirical evidence demonstrating these associations, we will not know whether proxy advisory firm guidelines are in the interest of shareholders.

Professional researchers have examined some aspects of ISS and Glass Lewis policies, and the results of these studies are mixed. Alexander, Chen, Seppi, and Spatt (2010) find ISS recommendations in contested director elections are positively associated with shareholder returns.[20] Larcker, McCall, and Ormazabal (2013) study stock option repricing plans and find that plans that conform to ISS criteria are associated with lower returns, lower future operating performance, and higher employee turnover.[21] In a separate study, Larcker, McCall, and Ormazabal (2015) find shareholders react negatively to companies that revise their executive compensation programs to make them more consistent with ISS guidelines for say on pay.[22] Conversely, Dey, Starkweather, and White (2023) find that companies that receive relatively low say-on-pay support and engage with ISS exhibit positive future returns.[23] Daines, Gow, and Larcker (2010) study ISS governance ratings and find they are not predictive of future operating performance, stock-price performance, or governance failure.[24]

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Our understanding of the rigor and reliability of proxy advisor guidelines would be greatly enhanced through additional study. Unfortunately, ISS voting recommendations have been removed from the databases that academics previously have used to conduct these studies, making future studies impossible.[25] Without access to voting recommendations, researchers are unable to assess the reliability and validity of proxy advisory firm guidelines.

QUESTION #4: HOW DO PROXY ADVISORY FIRMS EVALUATE INDIVIDUAL DIRECTORS?

Proxy advisory firms provide voting recommendations on individual director nominations at all public companies. The sheer number of directors makes this work onerous. By one count, there are approximately 40,000 directors of public companies in the U.S. alone.[26] To provide an accurate assessment requires knowledge of the skills, domain expertise, and boardroom contribution of each director. From a practical perspective, it is challenging to develop an informed view of each director without access to the individuals themselves or some insight into how board meetings are conducted.

Proxy advisors say little about how they determine the effectiveness of directors. Glass Lewis says it assesses directors on their independence and performance.[27] ISS evaluates them on independence, board composition, responsiveness, and accountability.[29] Beyond, this, we do not know how proxy advisors measure the effectiveness of a director at the individual, committee, or board level.[29]

Cai, Garner, and Walkling (2009) and Choi, Fisch, and Kahan (2010) show that ISS and Glass Lewis recommendations influence the voting results of uncontested director elections, while Alexander, Chen, Seppi, and Spatt (2010) show they heavily influence contested elections.[30]

The recommendations of proxy advisors will take on newfound importance in the age of universal proxies, in which activist investors are able to directly nominate dissident board members side-by-side with the company's nominees on the annual proxy.[31] Proxy advisors will be positioned to directly influence the composition of public boards by recommending a vote for certain individual candidates over others. Whether they are able to reliably weigh the merits of competing individual nominees is an open question.[32]

QUESTION #5: CAN PROXY ADVISORS DETECT "EXCESSIVE" CEO PAY?

Few matters in corporate governance are more controversial than executive compensation. According to one survey, 75 percent of Americans believe CEO pay is too high.[33]

For this reason, stakeholders pay considerable attention to the voting recommendations of proxy advisory firms.[34] One study shows negative recommendations from ISS and Glass Lewis reduce support for say-on-pay by around 30 percent.[35] Another estimates 25 percent. Data on equity plan proposals suggest an impact of approximately 20 percent.[36]

ISS and Glass Lewis have developed elaborate models to inform their voting recommendations for executive pay plans. Glass Lewis takes into account the relation between pay and company performance, the mix of short- and long-term incentives, the mix of variable and fixed elements, the relation between pay and risk, the choice of peer groups, and disclosure practices. It recommends against "excessive bonuses," "excessive risk-taking," and "excessive payouts."[38]

ISS considers many of these same factors and generally recommends against pay packages that include what it describes as "problematic" elements. These include "egregious" pay contracts, "overly generous" new-hire packages, "abnormally large" bonuses without a clear link to performance, "excessive" perquisites, and "problematic" severance (see Exhibit 4).[39] ISS also recommends against multi-year employee equity plans that exceed proprietary thresholds for total shareholder value transfer (SVT).[40]

While both firms provide extensive disclosure about their pay recommendations, we do not know how these firms determine which practices are excessive or egregious. Professional researchers have extensively studied CEO pay and, overall, little consensus exists about whether CEO total compensation on average is set at the right levels, whether it is properly aligned with performance, and whether it encourages appropriate risk-taking.[41] It might be that proxy advisory firms have independently developed frameworks to distinguish fair and unfair pay practices; if so, these models have not been externally vetted.

Nevertheless, companies pay careful attention to proxy advisory guidelines when designing pay. A study by The Conference Board, NASDAQ, and the Rock Center for Corporate Governance at Stanford University finds that approximately three-quarters (72 percent) of publicly traded companies review the compensation policies of a proxy advisory firm and a significant percentage of these make changes to pay structure in response.[42]

Edmans, Gosling, and Jenter (2023) find that approximately half of companies (53 percent) offer less pay to the CEO than they otherwise would in order to avoid a negative recommendation from a proxy advisory firm.[43] Jochem, Ormazabal, and Rajamani (2021) find that CEO pay levels have declined in variation within industry and size groups, with proxy advisor influence being one cause of this decline; they find negative shareholder outcomes associated with this trend.[44] Cabezon (2024) finds that the

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distribution of pay components—salary, bonus, equity, and other elements—across firms has also become more standardized, with pressure from proxy advisors one cause of this trend; he too finds standardization to be associated with lower shareholder value.[45] It is far from clear that these outcomes are beneficial to shareholders and stakeholders.

QUESTION #6: DOES A PROXY ADVISOR'S VIEW OF ESG INFLUENCE ITS RECOMMENDATIONS?

Proxy advisory firms are known primarily for recommendations on traditional corporate governance concepts. While they also provide recommendations for shareholder resolutions on environmental and social matters, their support—at least historically—was fairly muted. For example, ISS generally has supported proposals to the extent they "enhance or protect shareholder value," address "business issues that relate to a meaningful percentage of the company's business," but do not concern matters "more appropriately / effectively dealt with through governmental action" or are otherwise "best left to the discretion of the board."[46]

With the rise of ESG investing and ESG issues, ISS has entered the business of providing ESG ratings. A rating is fundamentally different from a recommendation on a proposed corporate provision. According to ISS, its ratings are

> *designed to enable institutional investors to support their investment strategies by assessing the environmental, social, and governance (ESG) performance of corporate issuers. In the context of the ESG Corporate Rating, ESG performance refers to a company's demonstrated ability to adequately manage material ESG risks, mitigate negative and generate positive social and environmental impacts, and capitalize on opportunities offered by transformation towards sustainable development.*[47]

The evaluation of ESG performance is a phenomenally complicated undertaking. Professional researchers have painstakingly scrutinized the methodologies and predictive ability of ESG ratings and are divided whether it is possible to evaluate ESG quality and, if so, whether a single rating has informational value.[48,49]

The risk for issuers is that a proxy advisor's view of ESG quality might influence its recommendations on proxy items in a way that is not in the interest of shareholders. For example, in the 2021 proxy contest between ExxonMobil and Engine No. 1, ISS backed three of the four directors put forward by Engine No. 1 because of their advocacy for ESG concepts, swinging the outcome of a closely run election just before a sharp upturn in traditional energy markets.[50] In 2024, ISS recommended against the reelection of five directors to the board of Berkshire Hathaway because of ESG factors, without regard to the recent or long-term success of the company.[51]

Spatt (2021) finds the proxy-maximizing incentives of proxy advisory firms are not aligned with those of investors and can encourage these firms to promote controversy or cater to ESG investors to increase own market share at the expense of beneficial owners.[52]

QUESTION #7: ARE PROXY ADVISORY FIRMS INDEPENDENT?

Institutional investors rely on proxy advisors to provide an independent assessment of proposed corporate and shareholder actions. However, whether proxy advisory firms are independent is an unresolved question. Some proxy advisors receive consulting fees from the same companies whose governance and ESG practices they evaluate, and the potential exists that they alter their voting recommendations to gain or retain business. Ma and Xiong (2021) show, using a theoretical model, that conflicts of interest can bias voting recommendations and decrease firm value.[53]

Some evidence suggests this might be occurring. Li (2018) examines voting recommendations and finds that ISS shifts its positions to make them more favorable to the preferred position of the client company when Glass Lewis initiates coverage of that company. He concludes "conflicts of interest are a real concern."[54]

Policymakers have the option to introduce safeguards to assure the independence of proxy advisory firms. One approach is increased disclosure. Malenko and Malenko (2019) and Edelman (2013) argue the quality of recommendations would improve through greater transparency.[55] An alternative approach would be to designate proxy advisory firms as fiduciaries. Spatt (2021) points out that these firms are outliers in the financial services industry, being subject to lower standards of accountability than institutional investors, auditors, and credit rating agencies. He argues that a fiduciary standard would align the interests of proxy advisors with those of shareholders.[56] Sharfman (2020) also makes this point.[57] Another approach, put forward by Manna (2021), would be to require greater separation between the consulting and advisory businesses of these firms.[58]

WHY THIS MATTERS

1. The proxy advisory industry is marked by considerable controversy regarding its purpose, influence, value, and objectivity. What is the reason for this controversy? Why have researchers been unable to demonstrate the purpose and role of these firms? Why do market participants and regulators disagree so starkly over their contribution? Is the proxy advisory industry—as currently structured—a net benefit or

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cost to shareholders?

2. Considerable disagreement exists over the influence that proxy advisory firms have on voting outcomes. What explains the large swings in voting outcomes that seem to be associated with their recommendations? Are investors making "informed decisions" based on information provided by these firms, or are they "blindly following" recommendations? Would the influence of proxy advisors be lessened if institutional investors were not required to vote?
3. Considerable evidence suggests that proxy advisor guidelines influence corporate practices, particularly in the area of compensation design. Are these guidelines associated with improved outcomes? What research do proxy advisory firms conduct to satisfy themselves that their guidelines are beneficial to shareholders and stakeholders? Why don't these firms provide greater transparency around their methodologies?
4. Proxy advisory firms have recently made the decision to remove their voting recommendations from research databases that professional researchers have used to conduct empirical studies on voting practices. As a result, future research into the questions discussed in this Closer Look will be greatly inhibited. What is the justification for this decision? ■

[1] James K. Glassman and Hester Peirce, "How Proxy Advisory Services Became So Powerful," Mercatus on Policy Series, Mercatus Center at George Mason University (June 18, 2014)

[2] The 2019 rule codified the role of proxy advisors as "solicitors" and subjected them to anti-fraud provisions. Following a lawsuit against the SEC by ISS, a Federal District Court later invalidated the 2019 rule, deciding that it exceeded the agency's authority. See Cydney Posner, "After 1576 days, DC District Court Holds Proxy Advisor Rule Invalid," Cooley PubCo (February 28, 2024).

[3] ISS provides recommendations on 50,000 shareholder meetings globally. See ISS, "About ISS: ISS Governance," available at: https://www.issgovernance.com/about/about-iss/ (accessed March 2024).

[4] Ibid.

[5] Glass Lewis, "Company Overview," available at: https://www.glasslewis.com/company-overview/ (accessed March 2024).

[6] Peter Iliev and Svetla Vitanova, "Investors' Voting Preferences," *Social Science Research Network* (April 18, 2023), available at: https://ssrn.com/abstract=4082127.

[7] Douglas Sarro, "Proxy Advisors as Issue Spotters," *Brooklyn Journal of Corporate Finance and Commercial Law* (2021).

[8] Andrey Malenko, Nadya Malenko, and Chester Spatt, "Creating Controversy in Proxy Advice," *Social Science Research Network* (November 6, 2023), available at: https://ssrn.com/abstract=3843674.

[9] Another way to increase controversy is to change the standard of what constitutes a close vote. For example, ISS gives special consideration to compensation director nominations and to executive compensation if, in the previous year, the company's say-on-pay proposal received less than 70 percent support (even though passage of say on pay is sufficient at a 50 percent threshold). See ISS, "US: Proxy Voting Guidelines, Benchmark Policy," (effective February 1, 2024).

[10] Christie Hayne and Marshall Vance, "Information Intermediary or De Facto Standard Setter? Field Evidence on the Indirect and Direct Influence of Proxy Advisors," *Journal of Accounting Research* (2019).

[11] Alon Brav, Matthew Cain, and Jonathan Zytnick, "Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting," *Journal of Financial Economics* (2022).

[12] Nadya Malenko and Yao Shen, "The Role of Proxy-Advisory Firms: Evidence from a Regression-Discontinuity Design," *Review of Financial Studies* (2016).

[13] James R. Copland, David F. Larcker, and Brian Tayan, "The Big Thumb on the Scale," Stanford Closer Look Series (May 30, 2018).

[14] Paul Rose, "Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting," *Social Science Research Network* (April 2021), available at: https://ssrn.com/abstract=3851233.

[15] Peter Iliev and Michelle Lowry, "Are Mutual Funds Active Voters?" *Review of Financial Studies* (2015).

[16] Securities Exchange Commission, "Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies," Release No. 25922 (Jan. 31, 2003).

[17] Initially, the SEC specified in a staff letter that the use of voting policies developed by an independent, third-party agency (such as a proxy advisor) would be viewed as non-conflicted (known as the "Egan Jones no-action letter"). In 2018, the SEC withdrew this letter. Securities and Exchange Commission, "Egan-Jones Proxy Services: No Action Letter," (May 27, 2004); and Securities and Exchange Commission, "Statement Regarding Staff Proxy Advisory Letters," Information Update, (September 2018).

[18] See ISS Governance, "2023 ISS Global Benchmark Policy Survey: Summary of Results," (2023); ISS, "ISS Benchmark Policy Updates," (effective February 1, 2024); and Glass Lewis, "2024 Benchmark Policy Guidelines," (2024).

[19] ISS, "ISS Benchmark Policy Updates," op. cit.

[20] Cindy R. Alexander, Mark A. Chen, Duane J. Seppi, and Chester S. Spatt, "Interim News and the Role of Proxy Voting Advice," *Review of Financial Studies* (2010).

[21] David F. Larcker, Allan L. McCall, and Gaizka Ormazabal, "Proxy Advisory Firms and Stock Option Repricing," *Journal of Accounting and Economics* (2013).

[22] David F. Larcker, Allan L. McCall, and Gaizka Ormazabal, "Outsourcing Shareholder Voting to Proxy Advisory Firms," *Journal of Law and Economics* (February 2015).

[23] Aiyesha Dey, Austin Starkweather, and Joshua T. White, "Proxy Advisory Firms and Corporate Shareholder Engagement," *Social Science Research Network* (January 2023), available at: https://ssrn.com/abstract=3871948.

[24] Robert Daines, Ian D. Gow, and David F. Larcker, "Rating the Ratings: How Good Are Commercial Governance Ratings?" *Journal of Financial Economics* (2010).

[25] In response to questions about how to access ISS voting recommendations, ISS has stated that it "will not be able to offer any options / channels to access that data set moving forward." Email to the library at Stanford Graduate School of Business, (July 2023).

[26] David F. Larcker and Brian Tayan, "Board Structure: Data" Stanford Quick Guide Series: Data Spotlight (2018).

[27] Glass Lewis, "2024 Benchmark Policy Guidelines—United States," op. cit.

[28] ISS, "ISS Benchmark Policy Updates," op. cit.

[29] The independence standards of ISS and Glass Lewis are different from those required by the New York Stock Exchange. See New York

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Stock Exchange, "NYSE Listed Company Manual: Section 303A.02, Independence Tests," available at: https://nyseguide.srorules.com/listed-company-manual/09013e2c8556747d.

[30] Jie Cai, Jacqueline L. Garner, and Ralph A. Walkling, "Electing Directors," *Journal of Finance* (October 2009); Stephen Choi, Jill Fisch, and Marcel Kahan, "The Power of Proxy Advisors: Myth or Reality?" *Emory Law Journal* (2010); and Alexander, Chen, Seppi, and Spatt (2010), op. cit.

[31] See Sidley Austin, "SEC Dramatically Changes the Rules for Proxy Contests, Adopts Universal Proxy," *Shareholder Activism Update* (November 17, 2021).

[32] ISS says of the new rules that boards "will be far less able to shield their weakest contributors." ISS also says its overall approach to evaluating contested proxies will not change. First it will consider "is there a case for change" and, if so, "how much change?" Then it will consider factors such as director age, tenure, number of outside board seats, qualifications, diversity of experience, and level of engagement. See ISS, "The Universal Proxy Card Era Begins," ISS Special Situations Research: Research Note (August 23, 2022).

[33] Ross Kerber, "U.S. Poll Finds Bipartisan Concern over High CEO Pay," *Reuters* (May 9, 2022).

[34] For example, the media regularly publishes stories regarding both positive and negative CEO pay recommendations. Over the past five years, Reuters published over 100 news stores regarding ISS or Glass Lewis pay recommendations for individual companies, including Alphabet, Apple, Credit Suisse, JPMorgan, Johnson & Johnson, Ryanair, Walt Disney, and others.

[35] James R. Copland, David F. Larcker, and Brian Tayan, "The Big Thumb on the Scale," op. cit.

[36] Malenko and Shen (2016), op. cit.

[37] James R. Copland, David F. Larcker, and Brian Tayan, "The Big Thumb on the Scale," op. cit.

[38] Glass Lewis, "2024 Benchmark Policy Guidelines—United States," op. cit.

[39] ISS, "Compensation Policies: Frequently Asked Questions—United States," (Updated February 2, 2024).

[40] According to ISS, Shareholder Value Transfer (SVT) "refers to an estimate of the value that the company will transfer to its employees and directors via certain equity-based compensation programs, as measured at a given date based on a standard set of inputs. ISS' proprietary compensation model calculates an SVT benchmark for each company—based on its market cap, industry, and relevant performance metrics relative to peers—which is used in evaluating the company's SVT." See ISS, "Equity Compensation Plans—Frequently Asked Questions," (Updated December 11, 2023). See also, David F. Larcker, Ian D. Gow, Allan McCall, Brian Tayan, "Sneak Preview: How ISS Dictates Equity Plan Design," Stanford Closer Look Series (October 2013).

[41] The preponderance of the evidence indicates that CEO pay is generally set in an efficient manner, even though many exceptions exist where poor governance leads to rent extraction. For an extensive review, see Carola Frydman, and Dirk Jenter, "CEO Compensation," *Social Science Research Network* (March 19, 2010), available at: https://ssrn.com/abstract=1582232; and Kevin J. Murphy, "Chapter 4—Executive Compensation: Where We Are, and How We Got There," Handbook of the Economics of Finance (2013).

[42] The Conference Board, NASDAQ, and the Rock Center for Corporate Governance at Stanford University, "The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions," Directors Note No. DN-V4N5, The Conference Board (March 2012).

[43] Alex Edmans, Tom Gosling, and Dirk Jenter, "CEO Compensation: Evidence from the Field," *Journal of Financial Economics* (2023).

[44] Torsten Jochem, Gaizka Ormazabal, and Anjana Rajamani, "Why Have CEO Pay Levels Become Less Diverse?" *Social Science Research Network* (2021), available at: https://ssrn.com/abstract=3716765.

[45] Felipe Cabezon, "Executive Compensation: The Trend Toward One Size Fits All," *Social Science Research Network* (February 2024), available at: https://ssrn.com/abstract=4714147.

[46] See ISS (formerly RiskMetrics Group), "2010 U.S. Proxy Voting Guidelines Summary," (January 2010). Compare to ISS, "ISS Benchmark Policy Updates," op. cit.

[47] ISS ESG, "ESG Corporate Ratings: Methodology and Research Process," (September 2023).

[48] In testing the information value of ESG ratings, two recent papers come to sharply opposing views. Krueger, Alves, and van Dijk (2024) study the relation between seven ESG ratings providers and stock-price performance over a 20-year period and find no association, while Berg, Lo, Rigobon, Singh, and Zhang (2023) study the performance of six ESG Ratings providers and performance over a 6-year period and find a positive association. Which is correct? See Philipp Krueger, Romulo Alves, and Mathijs A. van Dijk, "Drawing Up the Bill: Are ESG Ratings Related to Stock Returns Around the World?" *Social Science Research Network* (March 2024), available at: https://ssrn.com/abstract=4770546; and Florian Berg, Andrew W. Lo, Roberto Rigobon, Manish Singh§, and Ruixun Zhang, "Quantifying the Returns of ESG Investing: An Empirical Analysis with Six ESG Metrics," *Social Science Research Network* (June 2023), available at: https://ssrn.com/abstract=4367367. For a detailed review of ESG Ratings, see David F. Larcker, Lukasz Pomorski, Brian Tayan, and Edward M. Watts, "ESG Ratings: A Compass Without Direction," Stanford Closer Look Series (August 2022).

[49] ESG ratings are also known to have low correlation across providers, suggesting they are either not reliably measuring the same construct or they are measuring different constructs—see Exhibit 5.

[50] See Svea Herbst-Bayliss, "Exxon under Pressure as ISS Backs Engine No. 1 Nominees in Board Fight," *Reuters* (May 14, 2021); and Andrew Ross Sorkin, Ravi Mattu, Bernhard Warner, Sarah Kessler, Michael J. de la Merced, Lauren Hirsch, Ephrat Livni and Vivienne Walt, "Reassessing the Board Fight That Was Meant to Transform Exxon," *The New York Times* (May 31, 2023).

[51] Jonathan Stempel, "ISS Rebukes Buffett's Berkshire Hathaway over Climate Change, Governance," *Reuters* (April 18, 2024).

[52] Chester S. Spatt, "Proxy Advisory Firms, Governance, Market Failure, and Regulation," *The Review of Corporate Finance Studies* (2021).

[53] Shichao Ma and Yan Xiong, "Information Bias in the Proxy Advisory Market," *The Review of Corporate Finance Studies* (2021).

[54] Tao Li, "Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry," *Management Science* (2018).

[55] Sagiv Edelman, "Proxy Advisory Firms: A Guide for Regulatory Reform," *Emory Law Journal* (2013); and Andrey Malenko and Nadya Malenko, "Proxy Advisory Firms: The Economics of Selling Information to Voters," *Journal of Finance* (2019).

[56] Spatt (2021), op. cit.

[57] Bernard S. Sharfman, "Now Is the Time to Designate Proxy Advisors as Fiduciaries under ERISA," *Journal of Corporation Law* (2020).

[58] Austin Manna, "Reducing Conflicts of Interest: A 'Glass-Steagall' Split of Advisory and Consulting Services of Proxy Advisory Firms," *Brooklyn Journal of Corporate, Financial & Commercial Law* (2021).

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EXHIBIT 1 — PERCEIVED MARKET ROLE OF PROXY ADVISORY FIRMS

Role of Proxy Advisors	Internal Stakeholders	Proxy Advisor Representatives	% Agreeing
Information Intermediary	Asset managers subscribe to several of these services as a starting point regarding how to vote proxies because, if they hold thousands and thousands of stocks, they can't afford—they don't have the time to read every single proxy during spring season and come up with their own views. … I think it's really good that there are these proxy advisors because, for the well-behaving, regular company, it does provide an efficiency in the system, and it would be awful for asset managers if these guys went away. … It's probably good that somebody's out there collecting the data, analyzing it, making recommendations, and providing the service to asset managers.	What we're trying to help clients do is really provide them with the tools they need so that they don't have to run around doing all the legwork, collecting all the data, and crunching that data to, again, have it in front of them to first now engage with companies but also ultimately make an informed voting decision. When I'm talking about data aggregation, I'm looking at it through that prism that we're giving the client what they want and what they say that they need in order to make that informed voting decision.	70.3%
Agenda Setters for Institutional Investors	[PAs] come up with what the appropriate proxy voting guideline should be around executive compensation. It's intended to give shareholders … the baseline framework in terms of what should be looked at and what should be reviewed when shareholders have to approve compensation arrangements or equity shareholder proposals. It does help set the baseline.	As I talked about before, part of why institutional investors hire us is to make their own voting processes more effective and efficient and to free them up to do the more thoughtful parts of the process.	24.3%
Safe Harbor	I do think companies have just let them [PAs] become too influential in the process. Like I said, a lot of that just comes down to the fact that a lot of shareholders just vote whatever the advisory firms recommend. … I actually think that the outsized influence is the result of a combination of companies letting them and shareholders blindingly following their advice as opposed to coming up with their own way to assess these things	You have to go back and think about what led to the creation of [PAs], right? There was a need for them. And that's [because] investment managers had to vote their shares, but they didn't have enough time or resources to allocate towards proper research for all the companies in their portfolios. So, essentially, that leads to them looking to outsource to the [PA firms].	54.1%

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EXHIBIT 1 — CONTINUED

Role of Proxy Advisors	Internal Stakeholders	Proxy Advisor Representatives	% Agreeing
Agenda Setter for Internal Stakeholders [companies]	You always get their summaries after your proxy vote. Glass Lewis and ISS will do a write-up. Those get dissected, and that gets presented in a comp[ensation] committee meeting so we understand their position on things. We get actually monthly score cards from ISS with our little score on the governance level. Comp[ensation] is just one of the things. We follow that. That gets circulated pretty broadly. We talk about it at comp [ensation] committee meetings. … Right now, we're having the discussion—I had it today. "Okay, we get dinged on this and this. If we want to do X, we probably should give on Y, because it's all this, really; it feels like a big mediation between all these parties.	I think it depends on the company. For, let's say, a Russell 3000 company, they might not necessarily care about the [PA] voting recommendation, especially if they have good relationship with their institutional investors. So, I think the outsized influence ... I would say that it's probably true for S&P 500 companies, and it's because of the optics as well. Because, for an S&P 500 company, if you get a negative vote recommendation from [PA firm] on, let's say, a say-on-pay proposal, then I think the market picks up on it, or sometimes, it's reported in the news. So, it becomes kind of embarrassing for the company, so that's why they would do everything in their power to make sure that they get a favorable vote recommendation from [PAs].	100%
Standard Setter	Companies tend to make design decisions based solely on what they think the advisory firms will recommend for their say on pay—whether the advisory firms will like what the company is doing. Again, I understand why but the companies are not sufficiently willing to decide what they want to achieve, design a plan that they think best addresses that, and move forward— even if they think the advisory firms are going to not like it, make a recommendation against their say on pay, their directors or whatever … I know a lot of my peers at similar organizations, as well as clients when I was in consulting, will make decisions based solely on what they think the proxy advisory firms are going to do.	Yeah, I mean, I don't think [PA firms] have gotten too powerful or have too much influence on compensation decisions. Actually, I definitely kind of disagree with that. I think ISS and Glass Lewis play an important role, though, in the overall process. Their policies are reflective of the investors and their clients. So, I think it's more about the investor base and what they're willing or interested in seeing in terms of compensation at these companies. And not as much [PAs] being overly influential.	100%

Source: Christie Hayne and Marshall Vance, "Information Intermediary or De Facto Standard Setter? Field Evidence on the Indirect and Direct Influence of Proxy Advisors," *Journal of Accounting Research* (2019).

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EXHIBIT 2 — INSTITUTIONAL INVESTOR ALIGNMENT WITH ISS

Alignment with ISS	Number of Institutional Investors	Assets Under Management ($ billions)	Number of Resolutions
100.0%	44	1,184	43,466
99.9%	62	1,663	58,019
99.8%	87	4,421	82,875
99.7%	95	4,537	88,811
99.6%	105	4,722	94,880
99.5%	114	5,010	106,450

Source: Paul Rose, “Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting,” *Social Science Research Network* (April 2021).

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EXHIBIT 3 — INSTITUTIONAL INVESTORS VOTING WITH ISS, BY ISSUE

	Director Nominations	Compensation Proposals	Governance Proposals	Blanket Proposals
Management recommends voting "for"	100.0%	68.8%	30.3%	0.0%
ISS recommends voting with management	93.0%	69.1%	39.2%	0.0%
Fund votes with management recommendation	93.8%	77.8%	60.6%	39.6%
Fund votes with ISS recommendation	93.8%	77.9%	75.1%	60.3%
Shareholder proposal	n/a	31.2%	70.0%	100.0%
Observations	2,131,300	248,393	136,814	74,699

Source: Peter Iliev and Michelle Lowry, "Are Mutual Funds Active Voters?" *Review of Financial Studies* (2015)

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EXHIBIT 4 — ISS "PROBLEMATIC" PAY PRACTICES

Problematic pay elements are generally evaluated case-by-case considering the context of a company's overall pay program and demonstrated pay-for-performance philosophy. Based on input from client surveys and roundtables, ISS has identified certain practices that are contrary to a performance-based pay philosophy, which are highlighted in the list below. ISS evaluates these practices on a case-by-case basis, considering the facts and circumstances disclosed.

Egregious employment contracts:
- Contracts containing multi-year guarantees for salary increases, non-performance-based bonuses, or equity compensation;

New CEO with overly generous new-hire package:
- Sign-on awards that are excessively large or insufficiently performance-based;
- Problematic termination-related equity vesting provisions;

Abnormally large bonus or incentive plan payouts without justifiable performance linkage or proper disclosure:
- Performance metrics that are changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance;
- Payouts made despite failure to achieve pre-established threshold performance criteria;

Egregious pension/SERP (supplemental executive retirement plan) payouts:
- Inclusion of additional years of service not worked that result in significant benefits provided in new arrangements;
- Inclusion of performance-based equity or other long-term awards in the pension calculation;

Excessive or extraordinary perquisites:
- Perquisites for former and/or retired executives, such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements;
- Extraordinary relocation benefits (including any home loss buyouts);
- Excessive amounts of perquisites compensation;

Problematic severance and/or change in control (CIC) provisions:
- Termination or CIC severance payments exceeding three times [base salary plus target/average/most recent bonus] (or that include equity gains or other pay elements into the calculation basis);
- New or materially amended arrangements that provide for CIC severance payments without loss of job or substantial diminution of job duties (such as provided by a problematic Good Reason definition, or by single-triggered or modified single-triggered provisions, where an executive may voluntarily leave for any reason and receive CIC severance);
- New or materially amended executive agreements that provide for an excise tax gross-up. Modified gross-ups would be treated in the same manner as full gross-ups;
- Excessive payments upon an executive's termination in connection with performance failure or payments made in connection with an apparent voluntary resignation or retirement;
- Liberal change in control definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring;
- A problematic Good Reason termination definition that presents windfall risks, such as definitions triggered by potential performance failures;

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EXHIBIT 4 — CONTINUED

Tax reimbursements: Excessive reimbursement of income taxes on executive perquisites or other payments (e.g., related to personal use of corporate aircraft, executive life insurance, bonus, restricted stock vesting, secular trusts, etc.; see also excise tax gross-ups above);

Dividends or dividend equivalents paid on unvested performance shares or units;

Internal pay disparity: Excessive differential between CEO total pay and that of next highest-paid named executive officer (NEO);

Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including but not limited to cash buyouts, option exchanges, and certain voluntary surrender of underwater options where shares surrendered may subsequently be re-granted);

Significant shifts away from performance-based compensation to discretionary or fixed pay elements; and

Other pay practices that may be deemed problematic in a given circumstance but are not covered in the above categories.

Source: Source: ISS Compensation Policies—Frequently Asked Questions (updated February 2024).

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EXHIBIT 5 — CORRELATION AMONG ESG RATINGS PROVIDERS

CA INSTITUTE (2021)

	MSCI	S&P	Sustainalytics	CDP	ISS	Bloomberg
MSCI	x	36%	35%	16%	33%	37%
S&P	36%	x	65%	35%	14%	74%
Sustainalytics	35%	65%	x	29%	22%	58%
CDP	16%	35%	29%	x	7%	44%
ISS	33%	14%	22%	7%	x	21%
Bloomberg	37%	74%	58%	44%	21%	x

Source: Kevin Prall, “ESG Ratings: Navigating Through the Haze,” blog posting at CFA Institute (August 10, 2021).

BERG, KOLBEL, AND RIGOBON (2022)

	MSCI	ISS	RepRisk	TVL	Viego-Eiris	S&P Global	Refinitiv
MSCI	1.00						
ISS	0.42	1.00					
RepRisk	-0.09	-0.33	1.00				
TVL	0.23	0.14	0.10	1.00			
Viego-Eiris	0.44	0.68	-0.39	0.12	1.00		
S&P Global	0.39	0.57	-0.40	0.09	0.67	1.00	
Refinitiv	0.40	0.63	-0.45	0.10	0.70	0.65	1.00
Sustainalytics	0.24	0.14	0.06	0.03	0.12	0.12	0.21

Source: Florian Berg, Julian F. Kölbel, and Roberto Rigobon, “Aggregate Confusion: The Divergence of ESG Ratings,” *Review of Finance* (2022).

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