

**UNITED STATES HOUSE OF REPRESENTATIVES**

**COMMITTEE ON FINANCIAL SERVICES**

**Hearing of the**

**Subcommittee on Capital Markets and Government Sponsored  
Enterprises**

**On**

**Examining the Market Power and Impact of Proxy Advisory Firms**

**June 5, 2013**

**Testimony of Lynn Turner**

I would like to thank Chairman Garret and Ranking member Maloney, and members of the Committee for the opportunity to testify today.

I am Lynn Turner and I work as a managing director at the economic and forensic consulting firm LitiNomics. My comments draw upon my past experience as a member of the board of directors of public companies; as a member of the board of two institutional investors, one a mutual fund and the other a public pension fund; as a member of management and financial executive; as a former regulator with the Securities and Exchange Commission (SEC) where I served as Chief Accountant; as a member of management of a semiconductor company and also a senior executive and head of research of Glass Lewis during its initial four years.<sup>1</sup>

My experience has given me a broad and balanced perspective of proxy voting, and a well informed insight into the process. In the past, as a corporate board member, I have been the subject of proxy voting recommendations. As Vice President and head of research at Glass Lewis, I have participated in and overseen the process with respect to the preparation of proxy voting recommendations provided to investors and asset managers. And as a board member of two institutional investors which voted proxies, I have been involved with establishment of proxy voting guidelines and the proxy voting process.<sup>2</sup> Currently, I am a governor appointee to the board of the Public Employees Retirement Association of Colorado (Colorado PERA), a pension fund that manages the investments for hundreds of thousands of Coloradoans. I chair the shareholder responsibility committee of the fund which oversees the proxy voting by the fund. However, the comments I express today are my own views and not necessarily those of the PERA board, which takes formal positions only after public discussion and votes.

### **Proxy Voting**

Proxy voting is an important right that the owners of public companies hold. These owners – investors – rely on the management teams to run the day to day operations of these companies and set their strategic and tactical plans. They also depend on members of the board of directors

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<sup>1</sup> I have not had any financial or other interest in Glass Lewis since I left over 6 years ago.

<sup>2</sup> At the mutual fund, a “fund of funds complex, we utilized Institutional Shareholder Services for voting recommendations. At Colorado PERA the fund uses research principally from Glass Lewis but also uses Institutional Shareholder Services.

to exercise reasonable oversight of management including among many items, their performance and ability to achieve expected results, compensation, and business investment decisions.

Proxy voting provides investors, and/or the asset managers managing their money, with a useful market based mechanism with which to establish the accountability of both the board of directors and management. It permits investors as owners of the company, to weigh in on important matters and to express their approval, or disapproval, of the performance of those on the board who serve as their elected representatives, just as members of Congress served those who elect them.

My experience has demonstrated that many, but perhaps not all, investors take this responsibility very seriously. I believe that if you examine the web sites of the largest public pension funds you will find almost all have their own custom proxy voting guidelines. Similarly, if you look at the websites of the 15 largest money managers such as Fidelity, Vanguard, and Blackrock, you will find they also have their own custom designed proxy voting guidelines, as well as staff dedicated to proxy voting.

Upon reading the proxy voting guidelines of some of these asset managers, it appears that they have adopted policies that are similar to those of the two proxy advisory firms, Institutional Shareholder Services (ISS) or Glass Lewis (GL) on some issues. However, I believe this is most often the result of many in the investment community having similar views on what is “good governance.” That is also why on proxy voting issues such as staggered boards, majority voting, pay for performance or poison pills, you will see investors at specific companies vote in agreement. In doing so, they may well vote in the same manner as ISS or GL have recommended. It is likely in such proxy contests, the asset managers would have voted similarly even if there had not been an ISS or GL recommendation.

My experience has informed me that the larger asset managers, such as Fidelity, Barclays or Black Rock, along with the large public pensions, are likely to follow their own voting guidelines and determinations, rather than those of ISS or GL. While they may buy research from the proxy voting services to gather useful information and assist with their analysis of the

issues, it is not uncommon they will vote differently than ISS or GL recommends, and often vote with management. And buying of such research, to add to one's available information about an issue, certainly should not be criticized in the context of trying to be fully informed about an issue. Interestingly, it is these large asset managers who also typically hold the largest percentage of institutional investment in public companies. I believe my experience is very consistent with useful data the Council of Institutional Investors (CII) has also provided the Subcommittee.

### **Proxy Voting in the Global Market Place**

In today's global markets, an asset manager may invest in dozens of capital markets, and in thousands of public companies. For example, at Colorado PERA, the fund makes and manages investments on a global basis in 7,000 to 8,000 companies. The proxies for these companies may involve the election of numerous directors, approval of compensation and acquisitions, shareholder initiatives submitted for shareholder approval, and any number of additional matters. Proxies in non U.S. markets are often the subject of different proxy laws and requirements requiring knowledge of each jurisdiction, if one is to vote responsibly. Some foreign countries have a very short period of time between when shareholders are informed of the matters subject to shareholder vote, and when the proxy votes must be completed.

Many mutual or pension funds do not have unlimited staff who can read thousands of proxies and then research and submit an informed vote on the issues as required. My experience tells me that it would take well over a hundred staff, at a very significant cost to vote 8,000 proxies in a global market place. That would be a cost that would have to be passed on to investors, significantly increasing their fees, and reducing their investment returns, and ultimately, the amounts they are trying to save for retirement.

Instead, the funds rely, in part, on research they can buy from ISS and/or GL or others, along with their own research and proxy voting guidelines, to make a decision on how to vote. From one perspective, this is not that much different from a board of directors who must rely on

management and staff of a company to keep up to date and informed about the business and in their conduct of board votes.

### **Transparency in Proxy Voting**

There is a significant amount of transparency today when it comes to proxy voting. For example, both ISS and GL post their proxy voting guidelines for all to see on their public web sites.<sup>3</sup> Most large pension and mutual funds also post their proxy voting guidelines.<sup>4</sup>

At Colorado PERA, the Shareholder Responsibility Committee reviews the proxy voting guidelines, in a public meeting, on an annual basis. The committee also reviews and analyzes the voting record of the fund on key and significant issues. Proxy votes that engender a lot of attention are also reviewed. At times, the PERA staff also contact me in advance of select votes to discuss those votes, which are subsequently also discussed in a public board meeting. At the mutual fund I served on the board of, we had a similar process with the exception that our board meetings were not public.

Much to their credit, ISS goes through a very robust public comment process each year in which their guidelines are posted for public comment. Comment letters received by ISS are also made public. ISS makes the updates and changes to their policies publicly available on their website as well. They also conduct significant outreach to various parties. I suspect that from beginning to end, their process is as transparent as, or more so than federal agencies may undertake with respect to rule making.

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<sup>3</sup> See GL proxy voting guidelines at: <http://www.glasslewis.com/issuer/guidelines/>  
ISS proxy voting guidelines are also available at  
[http://www.issgovernance.com/policy/2013/policy\\_information](http://www.issgovernance.com/policy/2013/policy_information)

<sup>4</sup> See Colorado PERA Proxy Voting Policy at:  
<https://www.copera.org/board/shareholdercommittee/ProxyVotingPolicy.pdf>

GL each year undertakes significant outreach to those investors who are their clients. They seek and receive from such clients their views on proxy voting issues. GL also interact with public companies receiving feedback.

However, it is important that the voters – investors who own the companies – determine their voting guidelines and how they will vote. It should not be up to non investors, to decide how the investors will vote on a particular issue. While it is more than fair to permit management to give their perspective on an issue, which they can do in the proxy statement they control, it would be highly improper for them to establish the rules with respect to how an investor will vote on a particular issue.

For example, I have heard some express a view that ISS or GL should have to submit drafts of their proxy voting recommendations to management before they can issue a final report. I find such a notion absurd, as in and of itself, it creates an inherent conflict with management permitted to edit a report on recommendations that affect them directly. It is akin to requiring teachers to submit report cards to students for editing before they can be sent home. While this is something we all might have liked at one point in time or another, I don't believe it is something that would improve the quality of grading.

However, as I discuss further below, I believe transparency in voting can and should be improved. Currently, mutual funds disclose once a year how they voted on proxies during the course of the year. By the time they disclose the vote, it is old news and history for the investors who have given them the money they manage. Investors deserve more timely information.

At Colorado PERA, we disclose our votes within 30 days. Other pension funds disclose their votes quicker. I believe more timely disclosure of votes by asset managers to investors should be required as I discuss below.

### **Does One Size Fit All?**

An issue I hear from time to time is that the proxy voting guidelines of GL, ISS or for that matter, mutual or pension funds are akin to a “check the box” approach to corporate governance and too rigid. Companies argue they should be tailored to each company. Given there are 8,000 to 10,000 public companies in the United States alone, that would take a lot of “tailoring.”

The practical reality today is that there is a fair degree of consensus around many, but not all, governance issues. For example, over the years, many of the large US public companies have agreed to accept a majority voting standard for directors. As a result, many proxy voting guidelines endorse such a governance measure. Likewise, many investors oppose the creation of poison pills or staggered boards that may hamper, rather than enhance shareholder value. As a result, these views, once viewed as “way out there” are now often contained in proxy voting guidelines. As a result, while such positions may be in the policy guidelines of ISS and GL, they are also likely to be in the custom guidelines of many other pension or mutual funds.

At the same time, pension and mutual funds do not view their proxy voting guidelines as rigid documents that must be followed on every vote. On occasion, at both the mutual and pension funds whose boards I have served on, I have received calls from our staff in which it was explained to me a waiver of our guidelines would be appropriate. The PERA guidelines in fact note that some issues will be voted on a case by case approach considering the fiduciary obligation the fund has to those whose money it manages. And while I was at GL, it was not uncommon at all that our clients would vote in a manner inconsistent with the GL guidelines. To say that GL dictates to their clients how they must vote couldn’t be further from the truth, a stretch of one’s imagination.

### **Myth Busters**

There are a couple of “Myths” with respect to proxy voting I would like to address. The first one is that ISS, GL or the pension funds are somehow “biased” against management and vote according to how the labor organizations would like them to vote.

In my opinion, if there is a bias, it is towards management. For example, Colorado PERA voted on 37,365 management proposals in 2012. PERA voted with management or against the shareholder on 32,039 of those proposals or 85.75 percent of the time. On 1,545 shareholder governance proposals, PERA voted with management on 924 of the proposals or 59.81 percent of the time as opposed to just 40.19 percent of the time with shareholders. I believe the Council of Institutional Investors and the Florida State Board of Administration have also provided the Subcommittee with evidence of a bias towards voting with management on issues.

Another indication of this bias towards management is in voting recommendations by ISS. According to ISS, to date in 2013, ISS has recommended a vote for directors of Russell 3000 companies 92.8 percent of the time as opposed to a withhold or against recommendation just 7.2 percent of the time. During the 2012 calendar year, ISS recommended for 91.3 percent of the nominees at Russell 3000 companies as opposed to a vote against or for withhold just 8.7 percent of the time. Given half of the companies in the market are underperforming the market and half are outperforming, votes for over 90 percent of the directors can hardly be construed as a bias against management and the directors. It is also worth noting that even when directors fail to garner a majority of support from the shareholders, they seldom resign, choosing instead to ignore the vote.

With respect to GL voting, to date in 2013, they have recommended a “withhold” vote against 19,952 directors or just 9.95 percent of the time. In 2012, in the election of 26,366 directors, they recommended a withhold vote 12.85 percent of the time, a similar percentage to their vote in 2011. Of 65 directors who failed to gain 50 percent of the support from their investors in 2012, GL recommended for 8 of those directors. Of 2011 directors who failed to get a majority support in 2011, GL had recommended a vote for 22 of those directors. Once again, the facts do show a bias toward management and existing directors.

The reality is that there are around 100 or fewer proxy voting contests each year that garner the attention of the press and media. These typically are the result of a significant event at a company including poor stock performance, large amounts of compensation coupled with poor



company performance, a financial debacle of some sort, or a failure of the board and management to adequately explain actions they have taken such as with respect to acquisitions.

A recent example of this was the proxy contest at Hewlett Packard. This company had total shareholder returns of a negative 22.5 percent over the recent five year period. During this period the company's market capitalization (value) had dropped precipitously. Management had to write off as worthless over \$19 billion they had paid out for acquisitions during that period. They had also gone through a number of CEOs and had experienced turmoil and turnover on the board. It is no wonder then that investors did express concern about the returns they were receiving on their investments, and the management and board of trustees who were stewarding the company. It was clearly not just labor funds who were involved with this contested proxy vote.

Another such example is the recent contested election of a director and chairman of the board at Occidental Petroleum Company (OXY). Oxy had a total shareholder return of just 1.89 percent over the previous five years. The company surprised the market by announcing they were seeking a new CEO, in a move viewed by some as driven by the former CEO who had become chairman of the board. The recently retired CEO had been one of the most highly compensated CEO's in America. This resulted in shareholders casting "... their shares against him by more than a 3-to-1 margin."<sup>5</sup> Clearly many investors were involved with this outcome, which was not driven by labor funds.

Another myth is that research reports from ISS and GL are inaccurate and contain many errors in data. Certainly, with up to 40,000 proxies being voted around the globe, and each of those proxies having a multiple of votes, some errors, while not desired, are inevitable given the process involves humans.

When errors do occur, there are mechanisms for addressing the issue. For example, on their website, GL has a web page for issuers. On this web page issuers can contact GL directly and

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<sup>5</sup> Dailey Finance at: <http://www.dailyfinance.com/2013/05/06/ray-irani-ousted-chairman-occidental-petroleum/>

make them aware of any errors.<sup>6</sup> It has been my experience, that when proxy advisors are made aware of errors, they respond in a responsible fashion, correct their reports, and republish them with the corrected information.

However, when I was head of research at GL, it was not uncommon that I would take a call and have a discussion with a company official regarding the “facts” in a report. However, the facts at times turned out to be correct, and it was really the recommendation that the official had a problem with. At other times a fact was wrong and needed to be corrected because the disclosures in the proxy were not clear. Since proxy advisors do rely extensively on the public disclosures in proxy statements, the quality and accuracy of their research can be limited by the quality of the proxy disclosures.

My experience using both GL and ISS reports are that they are typically correct, and provide a reasonable basis for the recommendation provided.

### **Recommendations**

As a former executive, I have found that one should always look for continuous improvement. I believe proxy voting is no different in that regards, and there are things that can be done to improve our proxy voting system. They include:

1. Improving transparency. I believe that proxy voting, and the votes actually made by asset managers should be transparent to the people whose money they manage on a timely basis, just as is done with political elections. Once a year, mutual funds do disclose their votes, often long after they have been cast and the elections are over. Instead, I believe asset managers should be required to disclose their votes to those who money they are managing at the time they actually vote.
2. Removing conflicts of interest. I strongly believe that one is very conflicted when they consult on how to establish or improve corporate governance or compensation plans, and then turn around and issue a recommendation on whether or not what the company has

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<sup>6</sup> See GL website: <http://www.glasslewis.com/issuer/>

done is acceptable. This is all too similar to having an auditor do the book keeping for a public company, and then opine on whether the books are done right or not. Congress has banned such conflicts for auditors and I believe a similar ban should be enacted for proxy advisors. While disclosure of these conflicts would be helpful, it is, in and of itself, insufficient.

3. Regulation and Oversight. Proxy advisory services provide a useful source of data and information. It is important that information is credible, reliable, and timely. It must also be conflict free and done in a transparent fashion. As a result, I believe proxy advisory services should be subject to SEC oversight.<sup>7</sup> The SEC should establish a regulatory scheme that makes sense and can achieve the desired result. While some have called for all proxy advisory services to register as investment advisors, I am not sure that regime is designed to adequately (or smartly) address regulation of proxy advisors who typically do not give investment advice. Rather regulation of proxy advisors should ensure they:
  - a. Fulfill a fiduciary obligation to recommend votes in a manner that is in the best interest of investors.
  - b. Provide credible, accurate and timely research.
  - c. Have a reasonable basis for recommendations they make.
  - d. Remain free of conflicts.
  - e. Have adequate training and compliance programs.
  - f. Ensure that confidential data is securely maintained.
4. Fiduciary Obligation. There has been discussion surrounding SEC regulations adopted in the last decade, and whether or not an asset manager can meet its fiduciary obligation by “outsourcing or farming out” the voting decisions to a proxy advisory firm. While I believe the proxy advisory firms do provide invaluable research into voting decisions that are made, and accordingly, are important to fulfilling a fiduciary obligation, I do not believe the research report of a proxy advisory firm can or should replace the fiduciary obligation of an asset manager to those whose money it is managing. Accordingly, I believe the SEC and Department of Labor should clarify who has the principal fiduciary obligation when it comes to proxy voting; that the fiduciary obligation cannot be

outsourced; and that all proxy votes must be done in a manner that is *solely in the best interest of the investors in a fund*. In addition, it should be clarified that if a board of trustees of a mutual fund “outsource” the proxy voting to an affiliate of the mutual fund complex, that affiliate has a direct fiduciary obligation to the investors as well.

5. Voting Standard. Today many of the largest companies in America have adopted a majority voting standard for election of directors. Yet in some limited instances directors have failed to receive the support of a majority of investors they represent. All too often such directors have remained on the boards, despite the lack of support for them from the owners of the business. As a result, I strongly believe a majority voting standard for directors should be enacted, and directors who fail to win the support of a majority of voting investors should not be allowed to continue to represent the investors.

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Thank you Mr. Chairman. I would be happy to respond to any questions you or members of the Subcommittee might have.

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<sup>7</sup> ISS is registered as an investment advisor. GL was initially registered as an investment advisor when it was created. However, upon advice from counsel, including a former SEC director of the Investment Management Division, GL deregistered and continues to be deregistered today.