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Subcommittee on the Administrative State, Regulatory Reform, and Antitrust
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"The Proxy Advisor Duopoly's Anticompetitive Conduct"

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Chairman Fitzgerald, ranking member Nadler, and distinguished members of the subcommittee,

Thank you for inviting me to testify this morning. Proxy advisory firms wield substantial influence over corporate governance, acting as pivotal intermediaries between institutional investors and publicly traded corporations. Their rise reflects a seismic shift in corporate governance and the way in which we conceptualize corporate democracy.

In the classic corporate governance archetype, informed shareholders vote their own shares.[1] So conceived, the primary problem facing policymakers and governance scholars is how to get firm managers (agents) to faithfully act in the interests of shareholders (principals) — i.e., to minimize agency costs.[2] This intellectual framework dominated late twentieth century corporate governance,[3] and numerous legal and market mechanisms were created or refined in an effort to enhance fidelity to shareholders' interests and minimize agency costs, particularly in the fields of executive compensation[4] and the rights and powers of shareholders *vis-à-vis* the board.[5]

However, the classic framework is largely a relic of a different era. Today, as a result of changing investor appetites,[6] increased demand for diversification,[7] and legal requirements for diversification

[1] *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").
[2] The seminal paper on agency costs is widely regarded as Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).
[3] *See* Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 WASH. U. L.Q. 327, 331 (1996) ("Managers and shareholders had potentially different interests: what economists call the agency problem. Thus, for the next sixty years, the intellectual mission of American corporate governance took the form of a search for the organizational Holy Grail, a technique that bridged the separation of ownership and control by aligning the interests of shareholders and managers").
[4] *See, e.g.,* Lucian Ayre Bebchuk & Jesse Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSP. 71, 71-72 (2003) ("Any discussion of executive compensation must proceed against the background of the fundamental agency problem afflicting management decisionmaking.").
[5] Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 777–78 (2017) ("Inspired by Jensen and Meckling, many scholars assert that corporate law should be reformed to give more power to shareholders. For example, such scholars condemn corporate-governance structures that insulate incumbent managers against hostile takeovers and activist hedge funds. And they apply similar reasoning to the conflict between controlling shareholders and minority shareholders, focusing on the potential for controllers to oppress the minority.").
[6] An important driver of these changing appetites has been the nature of employee-sponsored retirement plans, which increasingly include a narrow set of mutual funds. *See* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1878 (2017) ("Under the predominant approach, though, American workers are not able to buy securities in public companies directly. Instead, they are given an option to invest in the funds of whatever mutual fund families with which their employer contracts. Although these families may have a seeming breadth of options because the investment choices are numerically diverse, those choices in reality consist only of the menus of funds of the fund families their employer has selected.").
[7] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights,* 113 COLUM. L. REV. 863, 884 (2013) ("The past thirty-five years have seen a sharp increase in U.S. household ownership of equities, but equity mutual funds have been the vehicle. As of 1977, approximately 20% of households owned equities directly. While the percentage of direct owners has remained stable, the rise in mutual fund investment has increased the percentage of households that own equities directly or through mutual funds by 30% to a total of 50%. The increase in household mutual fund ownership has been significantly advanced by the portfolio theory of diversified investing.").

for certain retirement plan assets,[8] among other factors, most investors hold equity assets indirectly through various intermediary agents.[9] As a result, the classic framework has largely been replaced by a new model of intermediation.[10]

The rise of intermediated equity ownership has fundamentally transformed shareholder voting. Although not all financial intermediaries wield voting power on behalf of their clients or beneficiaries,[11] those that do have essentially become the default channel through which most American investors access our capital markets.[12] For instance, when investors purchase mutual fund or ETF assets, the asset manager (rather than the investor) exercises voting power with respect to the underlying equity securities.[13] Similarly, ERISA fiduciaries are obligated to make voting decisions for stock held by ERISA plans.[14] Likewise, state constitutions frequently oblige public pension funds to make proxy voting decisions on behalf of their beneficiaries.[15] The result is that the majority of individual investors own stock through intermediary agents that exercise governance rights—either independently or via proxy advisors—and thereby generate governance costs.[16]

The rise of proxy advisors can be viewed as a response to this transformation, emerging to serve the unique needs of intermediaries and institutions engaged in governance activities. Broadly, proxy advisors play a variety of roles. First, they provide research and analysis on the wide range of issues that arise in the course of governance decision making, ranging from the election of corporate directors to "say-on-pay" votes about executive compensation to shareholder proposals.[17] Second,

[8] *See* Peter Molk & Adriana Z. Robertson, *Discretionary Investing by "Passive" S&P 500 Funds*, 41 YALE J. ON REG. 248, 263 (2024) (discussing diversification requirements for certain funds).
[9] Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195, 205 (2022) ("Today most dispersed shareholders own their shares through intermediaries such as BlackRock, Fidelity, and Vanguard.").
[10] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013) ("Equity ownership in the United States no longer reflects the dispersed share ownership of the canonical Berle-Means firm. Instead, we observe the reconcentration of ownership in the hands of institutional investment intermediaries, which gives rise to 'the agency costs of agency capitalism.'")
[11] Notably, brokers are effectively barred from discretionary voting. *See* Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11, 13–14 (2017) (discussing the "virtual elimination of discretionary broker voting").
[12] *See* Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195, 205 (2022) ("Most investors own stock via a financial intermediary, generally a mutual fund. Currently, these institutions vote on behalf of their investors, almost universally taking the view that they have a fiduciary duty to vote for the value-maximizing outcome.").
[13] *See* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8188, Exchange Act Release No. 47,304, Investment Company Act Release No. 25,922, 68 Fed. Reg. 6564, 6580 (Jan. 31, 2003) (referring to mutual funds' "fiduciary duties to vote proxies of portfolio securities in the best interest of fund shareholders").
[14] 29 CFR Part 2550 ("The Department has a similarly longstanding position that the fiduciary act of managing plan assets that involve shares of corporate stock includes making decisions about voting proxies and exercising shareholder rights.").
[15] *See* Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2021 COLUM. BUS. L. REV. 840, 877–78 (2022) ("Formally, state constitutions or statutes often require trustees to consider only the interests of beneficiaries when making investment and voting decisions.").
[16] *See* Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195, 205 (2022) ("Most investors own stock via a financial intermediary, generally a mutual fund.").
[17] *See* Michael Simkovic, *Natural-Person Shareholder Voting*, 109 CORNELL L. REV. 1525, 1572 (2024) (discussing how intermediaries turn to "advice and recommendations from proxy advisory services such as ISS and Glass-Lewis").

proxy advisors issue recommendations on how shareholders should vote on various ballot items.[18] Third, some proxy advisors offer custom voting policies, wherein the advisor offers the opportunity to tailor its voting recommendations to suit the values or preferences of its clients.[19] Fourth, proxy advisors may provide vote execution services, thus streamlining the actual process of executing votes.[20] Finally, some proxy advisors offer consulting services to their clients, such as advising management with respect to governance decisions, executive compensation packages, sustainability policies, or cyber risk programs.[21]

Notably, the primary clients of proxy advisors are not ordinary investors, but large institutional intermediaries, such as mutual funds. As a result, the policy issues surrounding proxy advisors are part of a larger problem of how the corporate governance system can incentivize non-owners to vote as owners would. The impact of various governance policies is important to owners because they ultimately possess the economic rights to the profit or loss stemming from the price movements of the underlying equity assets—put simply, owners often have substantial "skin in the game," while many financial intermediaries and other market participants do not. Proxy advisors, in particular, do not capture any of the gains from share price increases, or suffer any of the losses from share price declines. They are effectively insulated from the consequences of their governance decisions, either good or bad. This insulation from the consequences of their own recommendations weakens their responsiveness to investor concerns, generates significant conflicts of interest, and leads to potential misalignment with key investor priorities.

Key Issues

In my view, the key issues in the proxy advisory industry can be consolidated into four broad categories: concentration, competition, subjectivity, and conflicts.

First, the proxy advisory industry is characterized by significant concentration. As others have testified, just two firms — Institutional Shareholder Services ("ISS") and Glass, Lewis & Co ("Glass Lewis") — control roughly 90% of the market for proxy advisory services.[22] This essentially duopolistic structure significantly limits the range of governance opinions available to investors. It may also generate systemic biases or amplify inaccuracies, potentially diminishing the health of our capital markets. The current concentrated market structure likely reduces incentives for

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[18] *Id.*

[19] Edwin Hu, Nadya Malenko & Jonathon Zyntick, *Custom Proxy Voting Advice* 2-3 (Nat'l Bureau Econ. Rsch., Working Paper No. 32559, 2024) (discussing custom voting policies).

[20] *See, e.g.*, *Proxy Voting Services,* INSTITUTIONAL INVESTORS SERVS., https://www.issgovernance.com/solutions/proxy-voting-services/ ("ISS' agile and secure technology enables you to manage the entire voting process and flawlessly execute your mandates, season after proxy season.").

[21] *See, e.g.*, *ISS-Corporate,* INSTITUTIONAL INVESTORS SERVS., https://www.issgovernance.com/solutions/proxy-voting-services/ ("ISS-Corporate helps companies design and manage their governance, compensation, sustainability, and cyber risk programs to align with company goals, reduce risk, and manage the needs of diverse stakeholders by delivering expert advisory, data, and software solutions.").

[22] Chong Shu, *The proxy advisory industry: Influencing and being influenced*, 154 J. FIN. ECON. 103810 (Apr. 2024).

experimentation and innovation, and it may generate an entrenched and artificially narrow set of governance standards.

Moreover, the concentrated nature of the proxy advisory industry enhances the influence of the major proxy advisors over firm-level voting outcomes. Research has suggested that ISS and Glass Lewis hold considerable sway over voting behavior, particularly for certain institutional investors. For instance, favorable ISS recommendations on equity plan proposals are associated with 17 percent more votes in favor, while favorable recommendations on uncontested director elections and proxy contests are associated with 18 and 73 percent more votes in favor, respectively.[23] In addition, receiving a favorable recommendation from Glass Lewis is associated with 16 percent increased support for say-on-pay votes, 12 percent increased support for equity plan proposals, and 64 percent increased support for proxy contest ballot items.[24] In a similar vein, a recent study found that clients of proxy advisors that issue a recommendation against management are 20 percentage points more likely to also oppose management than other investors.[25] These trends appear to be exacerbated by reliance upon the major proxy advisors' voting platforms — among those funds that subscribe to both ISS and Glass Lewis's recommendations, vote behaviors more closely parallel the recommendations of the proxy advisor upon whose voting platform they rely.[26]

Second, and closely related to the prior point, the corporate governance ecosystem would significantly benefit from enhanced competition in the proxy advisory industry. A key point here is that it is not only the number of meaningful competitors that is deficient, but also the *nature* of that competition. To the extent the current market is competitive, such competition often involves catering to the needs and preferences of intermediary agents rather than those of the actual investors and beneficiaries whose retirements are at stake. These intermediaries serve as governance gatekeepers with respect to their investors' assets, and they often face financial incentives to focus more on fulfilling their own compliance obligations than faithfully stewarding client funds.[27]

A lack of meaningful competition, as well as competition that is improperly targeted, may limit innovation and impede market-driven checks and balances. In the absence of adequate competitive pressures, proxy advisory firms have far weaker incentives to ensure accuracy, neutrality, and investor alignment, which may reduce the quality of corporate governance advice available to investors. Moreover, market dominance risks elevating the two largest proxy advisors into a quasi-regulatory role, allowing them to influence important governance issues such as which items should be considered financially material, the standards for director independence, and the effective voting thresholds for board action in response to shareholder proposals.

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[23] James R. Copland, David F. Larcker, & Brian Tayan, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, STAN. CLOSER LOOK (May 30, 2018), https://gsbpreserve.stanford.edu/file/87528/content.
[24] *Id.*
[25] Shu, *supra* note 30 at 103810.
[26] *Id.*
[27] For a more in-depth discussion of these issues, *see,* Caleb N. Griffin, *Mass Corporate Governance*, 103 WASH. U. L. REV. ___ (forthcoming 2026) (available at https://ssrn.com/abstract=5227132).

Third, the governance issues at stake are often the subject of significant controversy, with empirical support existing for both sides of many contested corporate governance issues. Thus, it is not the case that proxy advisors can easily serve as a neutral arbiter helping intermediaries find some universally agreed upon "right answer."[28] Because many governance issues lack definitive answers, particularly with respect to unique firm-specific questions, proxy advisors and the intermediaries that they serve are generally able to take virtually any approach to a given issue area without restriction or restraint.[29] This gives proxy advisors significant power, which is often largely unconstrained by existing fiduciary or legal obligations.

Fourth, and perhaps most critically, proxy advisors suffer from important conflicts of interest. For instance, both ISS and Glass Lewis provide certain consulting services, whereby they advise clients on governance issues and, subsequently, influence voting outcomes on those very issues. Thus, the major proxy advisors occupy multiple roles, both *advising* clients on what constitutes "good governance" and *deciding* what constitutes "good governance." This dual capacity, effectively both advisor and judge, generates an important structural conflict. Companies and investors may perceive, accurately or not, that paying a proxy advisor for governance consulting will influence the advisor's voting recommendations. Although the dominant proxy advisors may take internal measures to help ameliorate this challenge to the objectivity of their recommendations, there is, to my knowledge, no clear regulatory protection. As a result, such conflicts or potential conflicts represent an important area for legislative and regulatory consideration.

For example, consider governance decisions related to executive compensation. ISS issues voting recommendations on the thousands of say-on-pay votes that occur every year. Research suggests that a negative recommendation from ISS on say-on-pay proposals is associated with 25% lower support overall — an impact indicative of "strong influence over shareholder votes."[30] Companies seeking to garner a favorable recommendation from ISS might be motivated to purchase ISS' "executive compensation solutions."[31] For an undisclosed fee, companies can consult with a "compensation expert" to design, monitor, and communicate executive pay programs.[32] The fact that ISS is generating revenue from its executive compensation consulting services while simultaneously influencing the outcome of say-on-pay proposals through its voting recommendations — i.e., judging the merits of the same executive compensation packages it was paid to advise — heightens the risk of problematic

[28] *See id.* at 20-34 (identifying sufficient disagreement in the empirical literature about which governance approaches best serve investors' interests).
[29] *Id.* at 33 ("Mass corporate governors are entirely unconstrained by extant mandates on the ends of corporate governance. Not only do similarly situated mass corporate governors routinely vote in opposite ways on controversial ballot items, even 'consensus' positions lack convincing empirical support.").
[30] Nadya Malenko and Yao Shen, *The Role of Proxy-Advisory Firms: Evidence from a Regression Discontinuity Design*, 29 REV. FIN. STUDIES 3394 (2016) ("Using a regression discontinuity design, we find that from 2010 to 2011, a negative ISS recommendation on a say-on-pay proposal leads to a 25 percentage point reduction in say-on-pay voting support.").
[31] *Executive Compensation Advisory Service*s, INSTITUTIONAL SHAREHOLDER SERV., https://www.iss-corporate.com/solutions/executive-compensation-advisory-services/.
[32] *Id.*

conflicts of interest. Much as Sarbanes-Oxley addressed similar conflicts of interest in the context of accounting firms,[33] some of the draft legislation in Congress today, such as the bill by Congressman Fitzgerald, aims to provide analogous protection in the proxy advisor context. In my view, the disclosure and prevention of conflicts of interest in our financial markets is not a partisan issue, but rather, an important protection for investors, companies, and American capital markets.

It should be noted that not only is the influence of proxy advisors already substantial, but it is likely to further increase. As asset managers face regulatory and market pressure with respect to their own proxy voting behavior, a number of them have begun to effectively transfer a measure of their own considerable corporate governance influence into the hands of proxy advisors.[34] While in some ways a salutary development, given the current market structure for proxy advisory services, such measures largely *shift* rather than solve the problem of concentrated and unaccountable intermediary power over corporate governance outcomes. Thus, as such programs become more widely adopted, an increasing portion of the concentrated governance influence currently held by the largest asset managers will be transferred to proxy advisors. Given the tens of trillions of dollars that such intermediaries currently manage, this shift may considerably enhance the number of shares with respect to which the dominant proxy advisors exert governance influence. As a consequence, the issues and proposals discussed today are likely to become even more significant going forward.

In conclusion, thoughtful and well-calibrated regulatory interventions could enhance competitiveness in the proxy advisory industry and generate significant benefits for the broader corporate governance ecosystem. In particular, policies emphasizing enhanced disclosure and transparency, greater responsiveness and accountability, increased investor choice and responsibility, and protections against conflicts of interest merit further study and consideration. Additionally, any such regulatory interventions should pay special attention to calibrating the potential costs imposed, particularly with respect to smaller competitors and new market entrants. Ultimately, targeted policy interventions have the potential to improve the performance and competitiveness of the proxy advisory industry, increase the overall quality of corporate governance, and enhance the health of U.S. capital markets.

Thank you again for inviting me to testify, and I look forward to your questions.

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[33] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in sections of 11, 15, 18, 28, and 29 U.S.C.A.).
[34] *See* Caleb N. Griffin, *Open Proxy*, 99 TUL. L. REV. 247, 255 (2024) (discussing the development of voting choice programs that transfer power from intermediaries to proxy advisors).