# (K)ISS off?

*Dawn of disintermediation of the arbiters.*

**BY HOFFER KABACK**

Times have changed in the governance world since fall 1998, when I participated as a panelist at a governance conference in Washington, D.C. organized by the Investor Responsibility Research Center (from which organization several of today's governance players emerged).

Featured appearances at that event were made by Mario — not by Andrew — Cuomo and by Jesse — not by Janet — Jackson. Immediately following his speech at the IRRC event, Rev. Jackson left for the White House to counsel President Clinton about the Monica Lewinsky mess.

It was, after all, still the 20th century.

A further indicium of the quaintness of those days is that, as he exited the ballroom where he had made his remarks, Rev. Jackson elegantly kissed the hand of a striking, statuesque woman standing next to me. It almost made her swoon.

Quaint, too, compared to today, is that, then, there were not too many proxy advisory firms around.

Institutional Shareholder Services (ISS), the main player, regularly put out written materials, but the physical production values thereof were not high and they arrived, weekly, by fax.

Moreover, much of ISS's commentary about pending mergers, proxy contests, etc. seemed to be written by junior analysts. The analyses were not sophisticated. The format was canned.

In subsequent years, ISS sharply elevated its game. And, there arose several new competitors (e.g., Glass Lewis and Proxy Governance).

Many money management firms became, and remain, subscribers to the services of these proxy advisory firms. Those services include ratings of the governance of public companies and recommendations about voting in contested and non-contested elections and on shareholder proposals.

These outfits are not without their sharp, and longstanding, critics. One is Ira Millstein, a senior partner at law firm Weil, Gotshal & Manges. At a Directors' Institute on Corporate Governance given by Practising Law Institute in 2006, for example, he said that he was particularly concerned that many money managers voted "in lockstep" with whatever ISS's recommendations were. (In reply, the redoubtable Pat McGurn of ISS asserted that Millstein had been "spreading that myth" for a while.)

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Millstein then went on to emphasize that perhaps the time had come for more governmental scrutiny of these unregulated entities.

Martin Lipton of law firm Wachtell Lipton is another critic. The firm made these comments to the SEC in October 2010 in response to a Commission Release regarding the structure of the proxy system:

"Proxy advisory firms wield enormous influence, both in setting general shareholder voting policies and over the outcome of individual votes, while holding no economic interest in issuers. Despite this enormous influence, they currently operate outside of the realm of most of the federal securities laws. Over the last two decades, this small hegemony of for-profit firms (which, as the [SEC] Staff has noted, are not free of conflicts of interest) have proclaimed themselves the arbiters of corporate governance practices, and have become so without accountability or regulation. This is to the detriment of both issuers and shareholders."

And that was just the opening paragraph.

Wachtell's recommendations included requiring registration of the proxy advisory firms under the Investment Advisers Act, enhanced regulation of conflicts of interest, and providing for issuer review of the firms' draft advisory reports before they are published. No such new regulation has yet been adopted.

In mid-January 2012, Lipton and Wachtell colleague David C. Karp wrote a short memorandum praising behemoth investment firm BlackRock ($3 trillion-plus under management) for having sent a letter to its larger investees inviting them to discuss their respective governance policies with BlackRock before getting involved with the proxy advisory firms. In that memo, Lipton and Karp convey their hope that "disintermediation of advisory firms" may perhaps now occur and that such a development might create "the possibility that long-term investors, and the companies in which they invest, can constructively resolve governance issues on a case-by-case basis."

So: Are proxy advisory firms, on net, good or bad for America? Does their own sparkling business success exemplify the beauty of free-market capitalism or, on the contrary, have they heretofore improperly and unfairly and ill-advisedly (from a policy standpoint) escaped federal regulation (as Wachtell and Millstein would have it)? Should they be disintermediated to the extent possible, or do they serve one or more demonstrably useful purposes? If the latter, are they useful really only to the money managers themselves, who enlist such firms' help in order to lighten their own workloads, or do proxy advisory firms also provide value to the ultimate beneficiaries for whom, and in whose interests, the money managers are supposed to be working?

(K)ISS off? Or let be? ■

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