PROXY ADVISOR INFLUENCE IN A COMPARATIVE LIGHT

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ABSTRACT

The reform of proxy advisors is on the U.S. regulatory agenda, with debate focusing on the extent of influence that these actors exert over institutional investors and corporate managers. But the debate examines the U.S. position in isolation from other systems. If we broaden our focus, we see that the factors usually cited for proxy advisors' influence exist similarly in the United Kingdom but that proxy advisors there exert significantly weaker influence than they do in the United States. Why this difference when we would expect a similar role for proxy advisors in both systems based on the presence of the usual explanatory factors? This Article examines this question, identifying other explanations—the role of institutional investor trade groups, the level of agreement on governance best practices, the strength of shareholder rights, and the role of the State—to help explain proxy advisors' greater influence in the United States. The Article then explores the implications of this analysis for proxy advisor reform in the United States.

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CONTENTS

INTRODUCTION

Why do proxy advisors—the third-party firms engaged by institutional investors to advise on how they should vote their shares—wield the influence they do over institutional investors and corporate managers? With proxy advisor reform on the regulatory agenda,[1] this question warrants attention, and yet most scholarly contributions have focused on the extent of proxy advisors' influence rather than the reasons for it. Indeed, policymakers and scholars tend to accept that proxy advisors can mitigate institutional investors' collective action problems; that legal rules and high levels of institutional investor ownership have created demand for proxy advisors' services; that the increased economic significance of investors' voting decisions has magnified their incentives to use proxy advisors; and that, though some of these factors have more explanatory power than others, together they generally explain proxy advisors' influence over institutional investors and corporate managers (difficult though measuring that influence has proved to be).[2]

This Article identifies other, unconventional explanations for proxy advisors' influence in the United States. The analysis begins with a puzzle. If we compare the United States with a system exhibiting similar laws, institutions, market actors (including proxy advisors), and other relevant characteristics—the United Kingdom—we observe the presence of the conventional explanatory factors in both. To be sure, there are differences between the systems as the comparison becomes more granular. But, at the level of abstraction at which the factors are often described, they exist in the United Kingdom as well, suggesting that institutional investors have broadly similar incentives to engage and rely on proxy advisors, giving proxy advisors somewhat similar influence. Yet, to the best of our knowledge, proxy advisors enjoy significantly stronger influence over institutional investors and corporate managers in the United States. Proxy advisors certainly attract greater regulatory attention and opposition from corporate managers and lobbyists in the United States than they do in the United Kingdom. Why this difference in the influence proxy advisors seem to wield, when we would expect a similar role for them in both systems based on the presence of the oft-cited explanatory factors enumerated above?

This Article identifies four explanations for this difference. It suggests that these explanations shed light on the reasons for proxy advisors' greater influence in the United States and deserve attention in the reform process. First, U.K. institutional investors have benefited from significantly stronger institutional investor trade groups. These groups have coordinated institutional investors,

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[1] For example, the U.S. House and Senate have introduced bills to regulate proxy advisory firms. *See* Corporate Governance Fairness Act, S. 3614, 115th Cong. (2018) (proposing to amend the Investment Advisers Act of 1940 "to require proxy advisory firms to register as investment advisers under that Act"); Corporate Governance Reform and Transparency Act of 2017, H.R. 4015, 115th Cong. (2017) (aiming to "improve the quality of proxy advisory firms for the protection of investors and the U.S. economy").

[2] For a more detailed discussion of these factors, see Section I.B.

collectivizing their voting power and diminishing the need for and space available for proxy advisors. In the United States, to a significant extent, proxy advisors serve as functional substitutes for trade groups; proxy advisor Institutional Shareholder Services ("ISS") and its peers perform key roles that investor trade groups undertake in the United Kingdom, making proxy advisors more influential in the United States. Second, corporate governance issues that are settled in the United Kingdom remain open—and are often vigorously contested—in the United States, which requires U.S. investors to make decisions that call for expertise and amplifies investors' incentives to turn to third parties for information and voting guidance. Essentially, what market participants in the United Kingdom regard as uncontroversial or settled in their best practice governance codes is still a source of dispute for their U.S. counterparts. Third, U.K. institutional investors have stronger rights as shareholders than their U.S. counterparts. These conditions have facilitated collective action by U.K. institutional investors, magnified their incentives to form trade groups, and made them more likely to coordinate their activities through trade groups than through proxy advisors. Finally, the State has played different roles in each system. In the United Kingdom, it has pushed for institutional investors to collectively influence corporate managers and has sometimes unambiguously threatened regulatory intervention unless they do, whereas in the United States it has exhibited suspicion of powerful institutional investors by imposing regulatory barriers to concerted action. Political forces have left U.S. institutional investors, relative to their U.K. counterparts, less likely to act collectively and, to the extent they do act collectively, more likely to act through third parties such as proxy advisors that can give them cover from political reprisal.

These various explanations are interrelated. They are also influenced by corporate managers, who in the United Kingdom have accepted stronger shareholder rights than those prevailing in the United States and have more willingly engaged with investor groups, helping to create conditions that encourage and strengthen such groups. Perversely, by resisting stronger shareholder rights and opposing reform on governance issues, U.S. corporate managers may have strengthened the proxy advisory firms that many of them now seek to weaken.

These four explanations—the role of institutional investor trade groups, the level of agreement on governance best practices, the strength of shareholder rights, and the role of the state—help explain proxy advisors' greater influence in the United States. They also have implications for proposed reforms affecting proxy advisors. If we need to rein in proxy advisors' influence, as recently proposed reforms have in mind, it is vital that we understand why proxy advisors wield the influence they do. Better understanding can generate a wider set of options for reform and help determine whether reforms are likely to be effective. For example, in September 2018, the Securities and Exchange Commission ("SEC") withdrew two no-action letters to ISS and Egan-Jones, respectively, that were interpreted to protect certain institutional investors from liability for fiduciary breach if they relied on the services of proxy advisors.[3] The withdrawal of the letters reflects a view that the letters contributed to proxy advisor influence. However, changes in rules, like removing protections from charges of breach, will have trade-offs.[4] Might other options, including strengthening shareholder rights through proxy reform, achieving wider agreement on governance best practices, or blunting large shareholder disclosure rules, be more effective in curtailing proxy advisors' influence? Understanding why proxy advisors wield the influence they do is a prerequisite for making successful choices about approaches to reform.

The analysis in this Article is exploratory. Comparative analysis has limits but produces useful insights. At some level of analysis, all similarities between systems eventually dissolve, which defeats the point of comparison. Identifying reasons for the influence of proxy advisors requires some conjecture. Comparative analysis cannot completely disentangle the various reasons for proxy advisors' influence or accurately ascertain their relative force. But comparative analysis can allow us to control for similar conditions that exist in multiple legal systems and prompts us to explore additional factors that may explain differences across systems. Comparative analysis can therefore shed light on the completeness of existing explanations as well as the merits of proposed reforms and alternatives to them.

Part I examines the conventional reasons given for proxy advisors' influence in the United States. It argues that these reasons apply with equal and sometimes greater force in the United Kingdom—and that, nevertheless, to the best of our knowledge, these firms enjoy significantly less influence over institutional investors and corporate managers in the United Kingdom. Part II deepens the comparison between the United States and United Kingdom, identifying four explanations for the differential influence of proxy advisors in these systems. Part III explores the implications of the analysis for the regulation of proxy advisors.

3 *See* Public Statement, Sec. Exch. Comm'n, Statement Regarding Staff Proxy Advisory Letters (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters [https://perma.cc/JM3U-GJEQ] (announcing withdrawal of previous SEC no-action letters regarding proxy advisory). The two no-action letters are: Institutional S'holder Servs., SEC No-Action Letter, 2004 SEC No-Act. LEXIS 736 (Sept. 15, 2004); and Egan-Jones Proxy Servs., SEC No-Action Letter, 2004 SEC No-Act. LEXIS 636 (May 27, 2004).

4 For example, institutional investors may exercise weaker oversight of their portfolio companies if fiduciary requirements are weakened to permit greater passivity by fiduciaries in monitoring their portfolio companies.

I. CONVENTIONAL EXPLANATIONS AND INITIAL U.S.-U.K. COMPARISONS

A. *U.S. Proxy Advisors: Roles and Influence*

In the United States, institutional investors have opportunities annually, and often more frequently, to vote the shares they hold for their clients.[5] Institutional investors hold shares in portfolio (or investee) companies. When they vote their shares, they typically vote by proxy; that is, they nominate a third party to cast their votes.[6] They often engage proxy advisors—firms such as ISS and Glass Lewis—that provide guidelines, recommendations, and other information to help investors vote their shares on the various proposals before them.[7] To some extent, therefore, institutional investors may rely on such input by proxy advisors in deciding how to cast their votes, giving proxy advisors influence over the voting decisions of institutional investors in director elections and other voting matters.[8]

Proxy advisors may also wield influence indirectly over portfolio company managers. Believing that investors will rely on the recommendations and other guidance provided by proxy advisors, corporate managers may adopt policies or make other decisions that they otherwise would not, in order to avoid opposition from proxy advisors.[9] This channel of proxy advisor influence operates in advance of voting by institutional investors, based on corporate managers' belief that proxy advisors exert influence directly over institutional investors.[10]

Proxy advisors may wield indirect influence in other ways. Through their guidelines, recommendations, and other statements, they make pronouncements that become public, attracting media and shareholder attention. In doing so, proxy advisors shape debates on governance questions and the merits of corporate transactions, potentially influencing managers. Proxy advisors may also contribute to public companies' "publicness"—the scrutiny companies face

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[5] *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-17-47, CORPORATE SHAREHOLDER MEETINGS: PROXY ADVISORY FIRMS' ROLE IN VOTING AND CORPORATE GOVERNANCE PRACTICES 1-5 (2016) ("[V]oting in shareholder meetings involves several key participants such as shareholders (including institutional investors) . . . .").

[6] *Id.* at 4-5 (explaining shareholders' ability to vote by proxy if they "decide[] not to attend the meeting").

[7] *Id.* at 5. Proxy advisory firms also provide other services to institutional investors, including facilitating the act of voting as well as recordkeeping. *Id.*

[8] *Id.* at 1-2.

[9] JAMES R. COPLAND, DAVID F. LARCKER & BRIAN TAYAN, PROXY ADVISORY FIRMS: EMPIRICAL EVIDENCE AND THE CASE FOR REFORM 13 (2018), https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf [https://perma.cc/J2TL-YLPQ] (examining evidence suggesting that proxy advisors have "significant influence over corporate choices" made in order to "win their approval").

[10] *Id.*

from outside actors that interpret and frame corporate actions and that thereby influence corporate decisionmaking.[11]

The degree to which proxy advisors' recommendations influence institutional investors has proved difficult to measure. Empiricists must determine whether a voting outcome is not simply correlated with a proxy advisor's recommendation but caused by it, a question that tests the limits of statistical inference.[12] At one extreme, a recommendation could be just one factor among many that an institutional investor weighs in deciding how to vote; at the other extreme, an institutional investor may follow the recommendation when it would otherwise have voted differently.[13] Empiricists cannot know how institutional investors would have voted if proxy advisors had made a different recommendation or had made no recommendation at all.[14]

As a consequence, scholars reach differing conclusions on the precise influence proxy advisors have over institutional investors in the United States.[15] Studies focus on voting outcomes based on proxy advisors' recommendations. For example, examining votes on shareholder proposals, Professors Jennifer Bethel and Stuart Gillian estimate that a negative ISS recommendation is associated with 13.6% to 20.6% fewer shares voting in favor of management proposals, depending on the topic of the proposal.[16] Professor Jie Cai and his coauthors find that directors facing uncontested elections who received negative ISS recommendations got 19% fewer votes (77% versus 96%).[17] Professors Stephen Choi, Jill Fisch, and Marcel Kahan find that proxy advisors have more modest influence in uncontested director elections: controlling for confounding factors including company performance, they estimate that a negative ISS recommendation shifted 6% to 10% of institutional investor votes.[18]

The evidence regarding proxy advisors' indirect influence is probably stronger. Evidence suggests that corporate managers are sometimes swayed by

[11] Professor Hillary Sale has developed a theory of "publicness," under which public corporations may be led to change in response to forces outside the corporation, often arising from public scrutiny. *See* Hillary A. Sale, Essay, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629, 1634-35 (2014).

[12] *See* COPLAND, LARCKER & TAYAN, *supra* note 9, at 12 (providing data demonstrating significant alignment between proxy advisor recommendations and institutional investor votes); Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisory Firms: Myth or Reality?*, 59 EMORY L.J. 869, 871 (2010) (analyzing difference between correlation and causation in terms of proxy advisor influence).

[13] COPLAND, LARCKER & TAYAN, *supra* note 9, at 11.

[14] *See id.*

[15] *See id*. at 13 ("The evidence suggests that proxy advisors have a material, if unspecified, influence over institutional voting behavior and therefore also voting outcomes.").

[16] Jennifer E. Bethel & Stuart L. Gillan, *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, 31 FIN. MGMT. 29, 46 (2002).

[17] Jie Cai, Jacqueline L. Garner & Ralph A. Walkling, *Electing Directors*, 64 J. FIN. 2389, 2403 (2009).

[18] Choi, Fisch & Kahan, *supra* note 12, at 906.

proxy advisors' recommendations, believing that institutional investors will act on them.[19] Proxy advisors' recommendations have been regarded as determinative in some corporate elections.[20] Corporate managers' decisions seem to be influenced by proxy advisors' guidelines and policies because these statements often set what become widely adopted governance standards. Professor Paul Rose regards proxy advisors as "play[ing] a significant role in directing corporate governance discourse" and, as a result, he questions "whether public company management is effectively being deprived of some essential latitude in how it may manage the company."[21] Many corporate managers and lobby groups regard proxy advisors as having outsized influence over corporate elections.[22] Recently, over three hundred public companies signed a letter to the SEC, calling on it to "take strong action to regulate proxy advisory firms" and referring "the large percentage of institutional voting that follows their recommendations."[23]

B. *Explaining Proxy Advisors' U.S. Influence*

Although commentators contest the precise degree of influence that proxy advisors exert in the United States, they advance fairly standard explanations for their influence.[24] First, proxy advisors lower the cost to institutional investors of

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[19] *See* COPLAND, LARCKER & TAYAN, *supra* note 9, at 13 ("[E]vidence suggests that proxy advisors have significant influence over corporate choices, particularly compensation choices."); Christie Hayne & Marshall D. Vance, *Information Intermediary or De Facto Standard Setter?: Field Evidence on the Indirect and Direct Influence of Proxy Advisors* 34 (Jan. 1, 2019), https://ssrn.com/abstract=3325622 (finding that corporate boards "succumb to [proxy advisor] influence by making changes to their compensation design both before and in response to proxy voting").

[20] Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 890 (2007) ("ISS advice has been cited as a decisive factor in a number of major corporate events . . . .").

[21] *Id*. at 918.

[22] *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 1-2 (describing concerns about proxy advisors' "disproportionate influence").

[23] Letter from Nasdaq, Inc. et al., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (Feb. 4, 2019), https://www.sec.gov/comments/4-725/4725-4872519-177389.pdf [https://perma.cc/XDD8-LJCK].

[24] *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 14-15 (identifying factors leading to increased demand and influence of proxy advisory firms); COPLAND, LARCKER & TAYAN, *supra* note 9, at 10 (citing economic and regulatory demand as driving forces for growth of proxy advisor power); JAMES K. GLASSMAN & HESTER PEIRCE, MERCATUS CTR., GEO. MASON U., MERCATUS ON POLICY: HOW PROXY ADVISORY SERVICES BECAME SO POWERFUL 1-2 (June 2014), https://www.mercatus.org/system/files/Peirce-Proxy-Advisory-Services-MOP.pdf [https://perma.cc/66M9-M9TH] (examining "sources of proxy advisory firms' power"); Randall S. Thomas & Paul H. Edelman, *The Theory and Practice of Corporate Voting at US Companies*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER 459, 474 (Jennifer G. Hill & Randall S. Thomas eds., 2015) (discussing factors that led to "the development of third party voting advisors" such as ISS); Robert B. Thompson, *The Power of Shareholders in the United States*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER, *supra*, at 441, 451-52 (examining factors that created to "an opening" for the services of proxy

voting, saving institutions from having to obtain and assess information in deciding how to vote.[25] This cost saving is important because shareholders, even institutional shareholders, face collective action problems, which produce weak incentives for shareholders to make informed voting decisions and to coordinate their actions.[26] Shareholders bear the full costs of coordinating with other shareholders and of voting, but capture only a fraction of any corporate gains that result from these actions (in proportion to their ownership interest).[27] They may not regard their actions or votes as determinative or pivotal.[28] Shareholders will therefore have weaker incentives to coordinate with other shareholders and make informed voting decisions. By lowering these impediments, proxy advisors' voting guidance and recommendations mitigate collective action problems.[29]

Second, institutional investors have significant holdings of shares in U.S. public companies (amounting to between 60% and 70% of the public company shares outstanding) and they vote virtually all of their shares (around 90%).[30] The proportion of public company shares held by institutional investors has steadily increased in recent decades.[31] With greater institutional investor holdings has come greater demand for proxy advisor services and greater potential influence for proxy advisors.[32]

advisors); Holly J. Gregory, Sidley Austin LLP, *SEC Guidance May Lessen Investment Adviser Demand for Proxy Advisory Services*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 29, 2014), https://corpgov.law.harvard.edu/ 2014/07/29/sec-guidance-may-lessen-investment-adviser-demand-for-proxy-advisory-services/ [https://perma.cc/KL8E-LQ29] (discussing why institutional investors rely on proxy advisors' recommendations).

25 *See* George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1288-89 (stating that appearance of proxy advisory firms significantly changed cost-benefit choices for institutional investors); Thomas & Edelman, *supra* note 24, at 474 (same); Thompson, *supra* note 24, at 451-52 (same).

26 ROBERT C. CLARK, CORPORATE LAW 94 (1986) (examining stockholders' incentives to free ride off efforts of other shareholders); Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Toward Proxy Contests*, 78 CALIF. L. REV. 1071, 1080-81 (1990) (discussing shareholders' weak incentives to inform themselves prior to proxy contests); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 454-57 (1991) (explaining why shareholders may not take individual actions even though it is in their collective interests to do so).

27 *See* Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 278 (2003).

28 *Id.*

29 *Id.* at 296.

30 *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 9; BROADRIDGE & PWC, PROXY PULSE: 2018 PROXY SEASON REVIEW 2-4 (2018), https://www.broadridge.com/_assets /pdf/broadridge-2018-proxy-season-review.pdf [https://perma.cc/AA39-4XDK]; *infra* Appendix A, Figures 1 and 2 (showing slightly lower figures for levels of non-individual/ household ownership than those reported in other sources).

31 *See infra* Appendix A, Figures 1 and 2. For limitation of these data, see *infra* note 277.

32 *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 13.

Third, the matters on which institutional investors may vote in corporate elections are often economically significant, giving institutional investors incentives to vote their proxies.[33] Professor Choi and his coauthors observe that relatively recent corporate governance changes have made shareholder voting more economically significant than in the past.[34] With more important decisions to make, institutional investors have stronger incentives to rely on proxy advisors' recommendations and other guidance.

Fourth and finally, legal rules provide incentives for institutional investors to engage proxy advisors for purposes of obtaining information and recommendations on how to vote.[35] Some commentators regarded the no-action letters withdrawn in September 2018[36] as rules having this effect (of incentivizing institutional investors' use of proxy advisors), which explains why the SEC's decision to withdraw the letters received support from those concerned about the extent of proxy advisors' influence.[37] The legal story began much earlier, in 1988, when the Department of Labor in its Avon Letter asserted to pension fund advisors that their fiduciary duties under the Employee

[33] *See* Choi, Fisch & Kahan, *supra* note 12, at 872-77 (explaining changes in corporate governance that lead to heightened importance of proxy voting); Gregory, *supra* note 24 ("Demand for proxy advisory services was also stimulated as an unintended consequence of the increased federal regulation of governance matters that gave shareholders greater voting rights with respect to traditional corporate governance matters, including, for example, the shareholder advisory vote on say-on-pay . . . .").

[34] *See* Choi, Fisch & Kahan, *supra* note 12, at 872-77 (citing changes in voting systems, destaggering of boards, new rules for uncontested director elections, and rise of institutional activism as causes of increased importance of proxy voting).

[35] *See* Gregory, *supra* note 24 ("Federal legislation and [SEC] rules and guidance are perceived to have played a role in the growth of proxy advisor influence."); *see also* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 14-15 (discussing 2003 SEC rule resulting in outsourcing of research and voting decisions to proxy advisory firms); COPLAND, LARCKER & TAYAN, *supra* note 9, at 10 (attributing rise of proxy advisory firms in part to SEC rule requiring more transparency in institutional investor proxy voting processes); GLASSMAN & PEIRCE, *supra* note 24, at 1 ("In the absence of regulatory encouragement to use [proxy advisory firms], institutional investors might rationally choose not to vote . . . ."); Thomas & Edelman, *supra* note 24, at 474 (attributing "development of third party voting advisors," including ISS, to rule changes on voting by institutional investors).

[36] *See supra* note 3 and accompanying text.

[37] *See* Steve Wolosky, Andrew Freeman & Ron Berenblatt, Olshan Frome Wolosky LLP, *SEC No-Action Letters on Investment Adviser Responsibilities in Voting Client Proxies and the Use of Proxy Voting Forms*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 18, 2018), https://corpgov.law.harvard.edu/2018/09/18/sec-no-action-letters-on-investment-adviser-responsibilities-in-voting-client-proxies-and-use-of-proxy-voting-firms/ [https://perma.cc/2PTL-H34T] ("The withdrawal of the no-action letters has been reported by the media as a 'win' for Republicans in Congress, the U.S. Chamber of Commerce and corporate lobbyists who believe proxy voting firms such as [ISS] and Glass Lewis have too much influence over corporate voting decisions, are not adequately held accountable for their recommendations and should be more heavily regulated.").

Retirement Income Security Act of 1974 extend to how they vote their proxies.[38] In 2003, the SEC took a similar approach to proxy voting by adopting Rule 206(4)-6 of the Investment Advisers Act.[39] Reflecting the notion that investment advisers act as fiduciaries when voting proxies, the rule required investment advisers to adopt and implement written policies and procedures reasonably designed to ensure that they voted proxies in their clients' best interests. In the rule's adopting release, the SEC clarified that these policies and procedures needed to address how investment advisers resolve conflicts of interest with their clients; such conflicts could arise when investment advisers also provided brokerage, banking, or other financial services to a portfolio company.[40] Importantly, the adopting release provided that investment advisers could demonstrate that they complied with their duties if they voted "in accordance with a pre-determined policy, based upon the recommendations of an independent third party."[41] Shortly thereafter, the SEC issued the Egan-Jones and ISS no-action letters, clarifying when a proxy advisor is "independent" under Rule 206(4)-6 and providing that voting in accordance with proxy advisor recommendations may protect an investment adviser from liability for fiduciary breach.[42] In 2014, the SEC made clear that investment advisers could not blindly rely on proxy advisor recommendations to insulate themselves from liability for fiduciary breach.[43]

U.S. rules therefore require many institutional investors to discharge fiduciary duties in deciding whether and how to vote their proxies. Institutional investors need not vote all of their shares, but when they do vote, relying on proxy advisors can help them satisfy their duties.

The upshot is that scholars and policymakers cite several factors to explain the influence proxy advisors exert in the United States. They accept that proxy advisors can mitigate institutional investors' collective action problems; that high levels of institutional investor ownership and legal rules concerning voting have created demand for proxy advisors' services; that the increased economic significance of investors' voting decisions has magnified investors' incentives to use proxy advisors; and that, though some of these factors have more

[38] *See* Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, Dep't of Labor, to Helmuth Fandl, Chairman of the Ret. Bd., Avon Prods., Inc. (Feb. 23, 1988), *reprinted in* 15 PENS. & BEN. REP. (BNA) 391, 392 (1988) (asserting that "fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies").

[39] Proxy Voting by Investment Advisers, 17 C.F.R. § 275.206(4)-6 (2018).

[40] Proxy Voting by Investment Advisers, Investment Advisers Act Release No. IA-2106, 68 Fed. Reg. 6585, 6587-88 (Feb. 7, 2003).

[41] *Id.* at 6588.

[42] *See supra* note 3 and accompanying text.

[43] *See, e.g.*, SEC Staff Legal Bulletin No. 20, 2014 SEC No-Act. LEXIS 333 (June 30, 2014) ("[A]n investment adviser that has retained a third party (such as a proxy advisory firm) to assist with its proxy voting responsibilities should, in order to comply with the Proxy Voting Rule, adopt and implement policies and procedures that are reasonably designed to provide sufficient ongoing oversight of the third party . . . .").

explanatory power than others, together they generally explain proxy advisors' influence over institutional investors and corporate managers.

C. *Initial U.S.-U.K. Comparisons*

When we turn to the United Kingdom, a puzzle arises that prompts deeper inquiry into and beyond the conventional factors explaining proxy advisors' influence in the United States. In the United Kingdom, the conventional factors would seem to exist, creating similar incentives for institutional investors to rely on proxy advisors. Yet, to the best of our knowledge, proxy advisors in the United Kingdom exert significantly weaker influence than they do in the United States.

The United States and United Kingdom are well-suited for comparison.[44] Their financial markets, laws, and institutions have long been considered closely comparable.[45] They are part of the same legal "family," having shared origins and similar legal institutions, traditions, procedures, and modes of reasoning—at least relative to continental European "families."[46] Their capital markets are deep and liquid.[47] Their public companies trade on major exchanges. Corporate shareholdings are broadly dispersed among retail and institutional investors, separating ownership from control, a feature that distinguishes these systems from other markets.[48] The U.S. and U.K. institutional investor landscapes are also similar, as described below, dominated by mutual funds (unit trusts and investment trusts in British parlance), pension funds, insurance companies, and other institutions. The investment management industry in the United Kingdom

[44] As is usual in comparative legal analysis, this Article treats the United Kingdom as a single, composite system, even though, formally, the United Kingdom comprises distinct national legislatures and judicial legal systems. For a discussion justifying treating the United Kingdom as a single, composite system, see MARC MOORE & MARTIN PETRIN, CORPORATE GOVERNANCE: LAW, REGULATION AND THEORY 53 (2017). This Article treats Delaware corporate law as reflecting U.S. corporate law, based on Delaware's dominance in attracting corporate charters.

[45] *See* COMM. TO REVIEW THE FUNCTIONING OF FIN. INSTS., REPORT 249 (1980) (describing the U.K. financial system as "more directly comparable to that in the USA" than those of other major countries); Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997, 2001-02 (1994) (noting similarities between the United States and United Kingdom).

[46] *See* KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 63-75, 181-82 (Tony Weir trans., 3d rev. ed. 2011); *see also* John Armour, Jack B. Jacobs & Curtis J. Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 265 (2011) (noting cultural and economic similarities between United States and United Kingdom despite different approaches to hostile takeovers).

[47] Black & Coffee, Jr., *supra* note 45, at 2001.

[48] *See* MOORE & PETRIN, *supra* note 44, at 12 ("[T]he equity securities of large-scale public corporations in the United Kingdom and United States, in stark distinction from those of their international peers, are *almost wholly* subject to 'outside' or non-entrepreneurial ownership.").

is second only in size to that in the United States,[49] although London's asset management industry is the largest of any city worldwide.[50] Major institutional investors operate in both markets, holding stock in both U.S. and U.K. public companies.[51]

Differences in U.S. and U.K. corporate laws are generally distinctions of degree rather than kind.[52] Corporate power is sourced in statutes, the common law, and corporate constitutional documents—the charter and bylaws of U.S. companies and the articles of association of U.K. companies. Such power is distributed between the two corporate organs: the board of directors and shareholders in general meeting. A board of directors manages the company's business affairs with minimal intervention from shareholders, while shareholders may elect or remove directors and have voting rights over other matters, including executive compensation plans, major corporate transactions, and changes to the constitutional documents.[53] Institutional investors have opportunities, typically annually, to vote the shares they hold for their clients

[49] THE INVESTMENT ASS'N, ANNUAL REPORT & ACCOUNTS 7 (June 2018), https://www.theinvestmentassociation.org//assets/files/reports/randa2017.pdf [https://perma.cc/HB7R-BN3V] (describing U.K. "investment management [market as] . . . the largest industry of its kind in Europe and the second largest in the world").

[50] *See* JOHN KAY, THE KAY REVIEW OF U.K. EQUITY MARKETS AND LONG-TERM DECISION MAKING: FINAL REPORT 32 (2012) ("London is the world's largest centre for asset management (although if funds managed from Boston and San Francisco are added to those of New York, the total of funds under management in the United States is greater)."). The terms "investment management" and "asset management" are typically used interchangeably.

[51] For example, BlackRock, State Street Global Advisors, and Vanguard—the "Big Three" institutional investors—invest in the United Kingdom. They have investment advisors that are U.K. subsidiaries. *See Members – Full*, INVESTMENT ASS'N, https://www.theinvestmentassociation.org/about-the-investment-association/members/full.html [https://perma.cc/67ZZ-GHL2] (last visited May 9, 2019) (listing the Investment Association's members, which include BlackRock Investment Management (UK) Ltd, State Street Global Advisors Ltd, and Vanguard Asset Management Ltd—all U.K. entities). In 2010, BlackRock was the largest asset manager in the U.K. *See* KAY, *supra* note 50, at 31.

[52] Geoffrey Miller, *Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England*, 1998 COLUM. BUS. L. REV. 51, 51 ("[S]uch differences [between the English and U.S. systems] do exist, although they are often matters of degree rather than kind."). Even legal doctrines considered unique to the United States, including the business judgment rule and fairness review, originated in U.K. law. For a detailed comparative study, see DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW (2018). The business judgment rule was "remarkably congruent" with U.K. doctrines. *Id*. at 131. U.S. fairness review for self-dealing transactions drew from English legal principles. *Id*. at 322-68.

[53] Put differently, in both systems, by default, the board is empowered to manage the corporation. *See* DEL. CODE ANN. tit. 8, § 228 (2019); Model Articles for Public Companies, Art. 3 (U.K.). For further detail on the U.K. position, see PAUL L. DAVIES & SARAH WORTHINGTON, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 355-66 (10th ed. 2016).

and often do so using proxies.[54] To some extent, institutional investors rely on proxy advisory firms—ISS and Glass Lewis, which are also prominent in the United Kingdom, together with local firms[55]—to provide voting guidelines, recommendations, and other information to assist institutional investors.

An initial inquiry into the U.K. landscape suggests the existence of the conventional factors enumerated above. The analysis begins with the first and second factors, considered together, dealing with institutional investors' collective action problems and high ownership levels, and then turns to the third and fourth factors.

Like their U.S. counterparts, institutional shareholders in U.K. public companies face collective action problems that proxy advisors can ease.[56] U.K. shareholders need to weigh in on director elections, executive compensation plans, "say-on-pay," and major corporate transactions—matters that may require significant time and expertise to assess. Institutional investors in both systems have portfolios of securities in the hundreds, if not thousands, of companies. Other than the very largest institutions, shareholders generally have limited personnel to research and make voting decisions.[57] Patterns of U.K. shareholding therefore create collective action problems,[58] much as they do for U.S. companies, generating incentives for institutional investors to use proxy advisors' services.[59]

In the United Kingdom, the shares of public companies are similarly concentrated in the hands of institutional investors.[60] Although available data is not directly comparable,[61] it suggests that investors other than individuals and households hold about 60% to 70% of the stock of U.S. public companies;[62] the corresponding figure in the United Kingdom is about 80% to 90%.[63] In 2016, the most recent year for which comparable data in both systems are available, mutual funds and pension funds—the institutional investors most likely to

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[54] DAVIES & WORTHINGTON, *supra* note 53, at 443 ("It is 'normal practice' in the United Kingdom to allow voting to be done by proxy.").

[55] U.K.-based proxy advisors also include Pensions & Investments Research Consultants ("PIRC") and Minerva Analytics.

[56] *See* G.P. STAPLEDON, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE 255-58 (1996) (discussing rational passivity of dispersed shareholders in the United Kingdom).

[57] *Id.*

[58] *See id.* at 255 ("[A] shareholder behaving in an economically rational way will undertake monitoring only in limited circumstances.").

[59] *Id.*

[60] *See infra* Appendix A, Figures 1-6.

[61] The U.S. data, for instance, is not confined to public companies. *See infra* note 277. The U.K. data can be difficult to interpret. *See infra* notes 258-264 and accompanying text.

[62] *See supra* note 30 and accompanying text.

[63] *See infra* Appendix A, Figures 4 and 6 (showing breakdown of shareholders by type); *see also* KAY, *supra* note 50, at 31 (showing beneficial ownership by individuals in 2010 of 11.5%). *See also infra* note 264 (discussing recent trends in U.K. share ownership).

engage proxy advisors—held 28.2% and 12.3% of all U.S. public company shares, respectively.[64] The corresponding figures (including non-U.K. shareholdings) for U.K. public company shares were 30.8% and 10.7%, respectively.[65]

Institutional investors in fact became major shareholders in public companies much earlier in the United Kingdom than in the United States. Institutional investors accumulated significant holdings in the United Kingdom in the 1950s, long before their U.S. counterparts did the same.[66] Professor Brian Cheffins attributes post-World War II changes in the distribution of U.K. public company shares to various tax rules, rules that encouraged both large shareholders to sell shares[67] and individual investors to buy shares indirectly, through institutional investors.[68] These forces allowed institutional investors to increase their holdings at the expense of other categories of shareholder.[69] Meanwhile, U.S. institutional investors faced legal restrictions on stock ownership, barriers that

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[64] BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: FLOW OF FUNDS, BALANCE SHEETS, AND INTEGRATED MACROECONOMIC ACCOUNTS, FOURTH QUARTER 2018, at 122 tbl. L.223 [hereinafter BD. OF GOVERNORS, FLOW OF FUNDS 2018]. *See also infra* Appendix A, Figure 1.

[65] *See* OFFICE FOR NAT'L STATISTICS, OWNERSHIP OF UK QUOTED SHARES: 2016 (Nov. 29, 2017), https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ ownershipofukquotedshares/2016 [https://perma.cc/672V-YD52]. For 2016 data regarding mutual funds (unit trusts and investment trusts) and pensions funds (excluding holdings by non-U.K. shareholders), see *id.* at 32 tbl.12 (showing holdings by unit trusts of 9.5%, investment trusts of 2.1%, pension funds of 3%, and non-U.K. ("Rest of the World") of 53.9%). The data for unit trusts, investment trusts, and pension funds was adjusted to include non-U.K. shareholders, as to which see *id.* at 25 tbl.5 and *id.* at 32 tbl.12. Shareholdings by non-U.K. shareholders were valued at £1,342.2 billion (including "North America" and "Other"), of which unit trusts held £477.7 billion (or 35.6%), investment trusts held nothing (0%), and pension funds held £191.2 billion (or 14.2%). Inclusive of non-U.K. shareholdings, therefore, unit trusts held 28.7% (calculated as 9.5% + (0.356 x 53.9%)), investment trusts held 2.1%, and pension funds held 10.7% (calculated as 3% + (0.142 x 53.9%)) of public company stock. *See also infra* Appendix A, Figure 3. As to non-U.K. shareholdings, see *infra* notes 258-264 and accompanying text.

[66] *See* John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1767-70 (2007) (contrasting early rise of institutional investors in United Kingdom with later development in United States, where "institutional investors became a significant force" only in 1990s).

[67] BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED 321-28 (2008).

[68] *Id*. at 344-49. Institutional investors in turn were influenced to allocate their funds to U.K. stock, rather than to other investment opportunities, by restrictions on foreign investment, favorable U.K. stock price performance, and new measures to protect shareholders. *Id*. at 350-60. For a detailed examination of the transformation of U.K. shareholdings from 1940 to 1990, see *id*. at 301-70.

[69] *Id*. at 344-49.

delayed the rise of institutional share ownership.[70] By the 1990s, the United Kingdom was still more institutionally dominated than the United States, with institutional investors holding two-thirds of public company stock compared with one-half in the United States.[71] High levels of institutional ownership in the United Kingdom therefore create demand for the services of proxy advisors much as they do in the United States.

As to the third factor—the economic significance of investors' voting decisions—in the United Kingdom, the resolutions on which shareholders vote are significant,[72] probably more so than the proposals on which U.S. shareholders vote. Commentators observe that the voting decisions of U.S. institutional investors have increased in economic significance in recent years,[73] pointing to the shift from plurality to majority voting, the widespread dismantling of staggered boards, and regulatory initiatives like "say-on-pay."[74] Still, U.K. shareholders probably still enjoy greater influence over corporate matters than their U.S. counterparts.[75] Professor John Armour and his coauthors observe that "the degree of institutional investor influence remains far greater in the United Kingdom than in the U.S."[76] Charter competition among U.S. states partially explains why corporate managers "exert far less influence" in the United Kingdom, which has a unitary (non-federal) system.[77] U.S. shareholders have traditionally had weak power to unseat directors through proxy contests, whereas U.K. shareholders have long been able to credibly threaten removal of underperforming directors in proxy contests.[78] In short, this factor—the significance of investors' voting decisions—exists in the United Kingdom, with no less force than it does in the United States.

The fourth and final factor concerns the legal rules that create incentives for institutional investors to rely on proxy advisors. The U.K. legal environment is roughly similar to that in the United States, again creating similar incentives for institutional investors to rely on proxy advisors. U.K. law imposes fiduciary duties on many institutional investors in voting their shares—duties that firms

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[70] Armour & Skeel, Jr., *supra* 66, at 1768-69 ("Unlike their American counterparts, British institutions were not held back from investing in stocks.").

[71] Black & Coffee, Jr., *supra* note 45, at 2002.

[72] *See* STAPLEDON, *supra* note 56, at 84-85 (listing numerous matters on which U.K. shareholders vote).

[73] *See, e.g.*, Choi, Fisch & Kahan, *supra* note 12, at 872-77 (citing numerous rules changes causing shareholder proposals to entail more "core economic and governance questions").

[74] *See id.*

[75] *See* Armour, Jacobs & Milhaupt, *supra* note 46, at 267 (providing historical explanation for U.K. shareholders' superior ability to influence boards and affect change of corporate matters).

[76] *Id.* at 268.

[77] *See* Armour & Skeel, Jr., *supra* note 66, at 1765-66 (crediting lack of federalism as reason that U.K. "corporate managers exert far less influence").

[78] Armour, Jacobs & Milhaupt, *supra* note 46, at 267 (stating that U.K. shareholders wield significant power over boards due to "very credible" threat of removal via proxy contest).

respond to by voting if doing so would serve the interests of their clients.[79] Since this claim about similar legal environments may surprise readers, I develop it in some detail.[80]

As in the United States, the precise duties that institutional investors owe when voting are somewhat uncertain in the United Kingdom. Many institutional investors are fiduciaries.[81] The relevant question is what, precisely, their fiduciary duties require. In 2001, the Myners' Report clarified the position for U.K. pension fund managers, stating that their fiduciary duties "require [them] . . . to vote proxies on issues that may affect the value of the plan's investment."[82] It observed that the U.S. Department of Labor's 1994 Avon Letter "correctly articulates" principles that apply to U.K. fund managers[83] and recommended that these principles be more explicitly incorporated into U.K. law.[84] After initially accepting this recommendation to clarify the duties of pension fund managers,[85] the government decided not to do so.[86] Instead, it included provisions in the Corporations Act allowing the U.K. Treasury or Secretary of State to pass regulations requiring institutional investors to disclose how they exercised their voting rights.[87] In deciding not to clarify the duties of pension fund managers, the government also accepted a proposal from the Institutional Shareholders Committee ("ISC"), an umbrella trade group for institutional investors, for the ISC to provide a voluntary code of best practices that the government would require institutional investors generally, rather than

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79 *See infra* text accompanying notes 81-100.

80 For further discussion, see *infra* Section III.E.

81 Under U.K. law, fiduciary duties arise in pension funds and mutual funds structured as trusts. *See* UNEP FIN. INITIATIVE, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT 100 (Oct. 2005), https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf [https://perma.cc/ZZ5K-K66H] ("[Fiduciary] duties arise only over institutional investments that are structured as trusts, such as pension funds and mutual funds."). Fund managers acting for fiduciaries would also seem to owe fiduciary duties. PAUL MYNERS, LONDON HM TREASURY, INSTITUTIONAL INVESTMENT IN THE UNITED KINGDOM: A REVIEW 92 (2001).

82 MYNERS, *supra* note 81, at 93.

83 *Id.*

84 *Id.*

85 *See* HM TREASURY & THE DEP'T FOR WORK & PENSIONS, MYNERS REVIEW: INSTITUTIONAL INVESTMENT IN THE U.K.: THE GOVERNMENT'S RESPONSE ¶ 11 (2001) (resolving to enact Myners' recommendation for "U.S. ERISA principles on shareholder activism [to] be incorporated into U.K. law").

86 *See* HM TREASURY, MYNERS PRINCIPLES FOR INSTITUTIONAL INVESTMENT DECISION-MAKING: REVIEW OF PROGRESS 28-29 (2004) (deciding not to incorporate principles of U.S. Department of Labor Interpretative Bulletin into U.K. principles).

87 Companies Act 2006, c. 46, §§ 1277-1278 (Eng.); *see also* Brian R. Cheffins, *The Stewardship Code's Achilles' Heel*, 73 MOD. L. REV. 1004, 1008-09 (2010).

pension fund managers specifically, to observe.[88] The ISC code evolved into the U.K. Stewardship Code,[89] which sets out broad principles that institutional investors should follow in monitoring and engaging with their portfolio companies.[90] The Stewardship Code, now the responsibility of the Financial Reporting Council, did not establish what institutional investors' fiduciary duties require of them in voting their proxies. It embraced the concept of stewardship by institutional investors with their portfolio companies—a concept more encompassing than mere institutional investor voting.[91]

The question of institutional investors' fiduciary duties was considered again in the 2012 Kay Review, which noted a lack of clarity in the law[92] and recommended that the U.K. Law Commission resolve it.[93] However, the Law Commission in 2014 answered both broader and narrower questions than the question posed by the Kay Review.[94] More broadly, it considered whether institutional investors were required to undertake stewardship activities.[95] More narrowly, it asked whether institutional investors were required to vote their proxies.[96] It answered no to both questions.[97] The Law Commission observed that institutional investors have discretion in deciding how to exercise their voting rights,[98] but did not articulate the fiduciary constraints on that discretion or how institutional investors might discharge their duties. In sum, many institutional investors do owe fiduciary duties in deciding whether and how to

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[88] The government referred to compliance with the ISC code as a "requirement," although its accompanying statement of principles provides that trustees "should comply" with the code. *See* HM TREASURY, *supra* note 86, at 28.

[89] The ISC principles became the ISC Code of Responsibilities and in turn, following a recommendation of the Walker Review, the Stewardship Code. FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE 2 (2012) [hereinafter STEWARDSHIP CODE] (explaining that the Financial Reporting Council "was invited to take responsibility for the Code" following the Walker Review).

[90] *Id*. ("The Code is directed in the first instance to institutional investors, by which is meant asset owners and asset managers with equity holdings in U.K. listed companies.").

[91] *Id.* (characterizing stewardship duties as more than voting, but rather including "monitoring and engaging with companies").

[92] KAY, *supra* note 50, at 66 (stating that while pension fund trustees are fiduciaries, "the legal position of other intermediaries is less clear"); *id*. at 68 (finding that there is "no . . . agreement on what the current legal standard of fiduciary duty is").

[93] *Id.* at 69.

[94] *See* THE LAW COMM'N, FIDUCIARY DUTIES OF INVESTMENT INTERMEDIARIES, 2014, HC 368, at 106 (UK) (clarifying concept of stewardship and duty to follow stewardship principles).

[95] *See id.*

[96] *See id.*

[97] *See id.* ("Whilst we recognise the importance of stewardship, our view is trustees have discretion over how far to engage with companies and to exercise their voting rights. Our conclusion is that, at present, there is no duty on pension trustees or other investors to undertake stewardship activities.").

[98] *Id.*

vote their shares. Precisely what those fiduciary duties require is uncertain,[99] although there are strong arguments that they require fiduciaries to vote when doing so would promote their clients' interests.[100]

It is reasonably apparent what institutional investors understand their responsibilities to be. Although the Stewardship Code operates on a comply-or-explain basis and has faced sharp criticism,[101] it is a core feature of the U.K. regime, shaping what market participants regard as best practices. Under the Stewardship Code, institutional investors must act in the interests of their clients.[102] Where conflicts with a client's interests arise, those conflicts should be managed "with the aim of taking all reasonable steps to put the interests of their client or beneficiary first."[103] Institutional investors "should seek to vote all shares held"[104] and should publicly disclose their voting records.[105] The Stewardship Code recognizes that institutional investors may rely on outside parties (a category that would include proxy advisors) to discharge their obligations, but makes clear that blind reliance on an outside party will not satisfy an investor's duties—a requirement similar to that in the United States.[106] Where institutional investors do rely on outside parties, they "should explain how this is compatible with the proper exercise of the institutional investor's stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement."[107]

Institutional investors overwhelmingly vote their shares, even though—like the U.S. regime—the U.K. regime does not require that they do so.[108] In the

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[99] *See* Arad Reisberg, *The U.K. Stewardship Code: On the Road to Nowhere?*, 15 J. CORP. L. STUD. 217, 245 (2015) ("It is . . . essential to clarify the meaning of fiduciary duties as applied to investment fiduciaries.").

[100] *See, e.g.*, MYNERS, *supra* note 81, at 93 (observing that the U.S. Department of Labor's 1994 Avon Letter "correctly articulates" principles that apply to U.K. fund managers); DAVIES & WORTHINGTON, *supra* note 53, at 416 ("Of course, it is strongly arguable that the fiduciary duties of pension fund trustees already require them to exercise their corporate governance rights actively if they judge that this will enhance the value of the trust's assets . . . .").

[101] *See, e.g.*, JOHN KINGMAN, INDEPENDENT REVIEW OF THE FINANCIAL REPORTING COUNCIL 8 (2018) ("The Stewardship Code, whilst a major and well-intentioned intervention, is not effective in practice."); *id*. at 46 (suggesting that in monitoring compliance with the Stewardship Code, the Financial Reporting Council focuses on policy statements not outcomes).

[102] STEWARDSHIP CODE, *supra* note 89, at 6 ("An institutional investor's duty is to act in the interests of its client and/or beneficiaries.").

[103] *Id.* (providing guidance on principle 2).

[104] *Id.* at 9 (providing guidance on principle 6).

[105] *Id.*

[106] *See supra* note 43 and accompanying text (describing U.S. requirement).

[107] STEWARDSHIP CODE, *supra* note 89, at 6 (providing guidance on principle 1).

[108] *See supra* text accompanying notes 81-100.

United States, some 90% of institutional investor shares are voted;[109] a recent survey puts the figure in the United Kingdom at more than 85%.[110] Similarly, both regimes recognize that institutional investors can rely on proxy advisors in satisfying their voting obligations but provide that reliance on a third party alone will not allow the investor to discharge its responsibilities. In the United States, investment advisers must oversee their proxy advisors;[111] in the United Kingdom, the provision for institutional investors to disclose how their reliance on outside parties accords with their responsibilities is more open-ended, but consistent with the U.S. guidance.[112]

The public disclosure of voting records would seem to create somewhat similar pressures in both systems, although data is not easily comparable. In the United States, mutual funds must disclose how they vote their shares.[113] Mutual funds account for some 28% of U.S. stockholdings.[114] The U.K. government

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[109] *See supra* note 30 and accompanying text.

[110] Alison Smith, *Institutional Investors Use Voting Rights*, FIN. TIMES (June 12, 2012), https://www.ft.com/content/4b24d2d4-b4a6-11e1-bb2e-00144feabdc0 ("More than 17 in 20 U.K. institutional investors exercise their right to vote at all the U.K. companies where they own shares, according to a survey by the Investment Management Association."). According to a 2016 survey, 99% of asset managers and owners that vote their shares in-house voted their shares in U.K. public companies while 73% of asset managers and owners that outsourced voting believed their shares were voted. *See* THE INVESTMENT ASS'N, STEWARDSHIP IN PRACTICE: ASSET MANAGERS AND ASSET OWNERS 7 (2016) (comparing rates of voting between asset managers who vote in-house and those that outsource voting). Since the 2016 survey fails to provide additional data such as the sizes of the shareholdings of both groups, one cannot determine the total percentage across groups. A 2018 survey finds that the median shareholder turnout in U.K. corporate voting—across both retail and institutional investors—was 77%. *See* INSTITUTIONAL S'HOLDER SERVS., 2018 EUROPEAN VOTING RESULTS REPORT 12 (2018), https://www.issgovernance.com/file/ publications/2018_European_Voting_Results_Report.pdf [https://perma.cc/6S6Y-RTQK] (providing statistics demonstrating gradual increase in turnout by "strategic stockholders"). Considering that retail investor turnout is typically weak, the figure for institutional investors alone would be greater than the aggregate figure. Anecdotal evidence further suggests that U.K. institutional investor turnout is high and similar in both the United States and United Kingdom. Professors Mats Isaksson and Serdar Çelik observe that the assumption that institutional investors will vote their shares "is particularly strong for the United States and the United Kingdom, where turnout levels are very high and institutional owners hold nearly 70% of the listed equities." MATS ISAKSSON & SERDAR ÇELIK, CORPORATE GOVERNANCE FORUM, CORPORATE GOVERNANCE IN TODAY'S EQUITY MARKETS AND THE ROLE OF INSTITUTIONAL INVESTORS – A PUBLIC POLICY PERSPECTIVE 69 (2018), http://kabstiftelse.se/wp-content/uploads/2018/03/CGF-OECD-trycket_inlaga-165x242_tryck_danagard.pdf [https://perma.cc/YVC2-GHCB].

[111] *See supra* note 43 and accompanying text (explaining SEC proxy voting rule, requiring oversight of third-party advisors).

[112] *See supra* text accompanying note 107 (providing guidance on principle 1 of U.K. Stewardship Code).

[113] *See* 17 C.F.R. § 270.30b1-4 (2018) ("Every registered management investment company . . . shall file an annual report . . . containing the registrant's proxy voting record for the most recent twelve-month period . . . .").

[114] *See supra* note 64 and accompanying text.

has, in effect, threatened to require mutual funds, pension funds, and insurance companies to disclose their voting by adopting statutory provisions allowing it to pass regulations requiring such disclosure.[115] The Stewardship Code provides that institutional investors should publicly disclose their voting records.[116] A 2016 survey of U.K. asset managers found that 55% of respondents disclosed all their voting records and that a further 17% disclosed a summary of their voting records.[117]

As in the United States, therefore, many institutional investors in the United Kingdom owe fiduciary duties. In both systems, institutional investors generally respond to their respective regimes by voting their shares. In voting, they have incentives to turn to proxy advisors for voting recommendations, guidelines, and other information. Both systems permit institutional investors to rely on proxy advisors in voting, but neither condones blind reliance them.

In sum, if we compare the United States with a system exhibiting similar laws, institutions, market actors, and other relevant characteristics—the United Kingdom—we observe the presence in both of the factors conventionally given to explain proxy advisors' influence. To be sure, there are differences between the systems as the comparison becomes more granular. But at the level of abstraction at which the factors are often stated, they exist in the United Kingdom—institutional investors facing collective action problems, governed by similar legal rules, seeking to achieve similar objectives, have broadly similar incentives to turn to third parties for information and advice.

The puzzle is why proxy advisors enjoy significantly weaker influence in the United Kingdom (that is, in relation to U.K. companies), both in terms of the extent to which institutional investors rely on proxy advisors' voting recommendations and more generally on the influence proxy advisors exert on institutional investors and corporate managers.[118] A study by accounting firm PwC replicated in the United Kingdom a study of the impact in the United States of an adverse ISS voting recommendation on pay and reached "strongly suggestive conclusions" that the impact of such an ISS recommendation in the United Kingdom was roughly half of that in the United States.[119] The U.K. law

[115] *See supra* note 87 and accompanying text (describing statutory provisions).

[116] STEWARDSHIP CODE, *supra* note 89, at 9.

[117] THE INVESTMENT ASS'N, *supra* note 110, at 45. The remaining twenty-eight survey respondents either did not publicly disclose their voting records or gave no response. *Id*. The report observes that disclosure levels have increased in recent years. *Id*.

[118] The qualification stated above applies here: the evidence fails to determine the precise extent of proxy advisors' influence. *See supra* notes 13-14 and accompanying text. The evidence is heavily contested in the United States. Even less evidence exists regarding proxy advisors' influence in the United Kingdom; the question is less politically salient. As to Europe-wide data, see *infra* note 119.

[119] PWC, ISS: FRIEND OR FOE TO STEWARDSHIP? 9 (2018), https://www.pwc.co.U.K./human-resource-services/assets/documents/iss-friend-or-foe-to-stewardship.pdf [https://perma.cc/ A5U5-YUSB] ("Overall, this suggests a best estimate for the causal impact of an adverse ISS voting recommendation in the U.K. at 10% to 15% points on average. This

firm Macfarlanes recently observed that proxy advisors, while "increasingly important in the UK, . . . are far less influential than in the US."[120] A prominent practitioner's guide on shareholder activism and engagement considers U.S. and U.K. law and practices under twenty-four identical topics; its U.S. guide makes frequent references to proxy advisors,[121] alerting practitioners to their prominent role, while the U.K. guide refers to proxy advisors once, classifying them as "[r]epresentative bodies," together with trade groups for institutional investors.[122]

In off-the-record interviews, I tried to gain a deeper understanding of differences between the roles proxy advisors perform in each system. I spoke with U.S.- and U.K.-based market participants, including officers at institutional investors, legal advisors to institutional investors and corporate managers, and former staff of proxy advisors.[123] Not all made comparisons between the United States and United Kingdom, but those that did described proxy advisors, including ISS, as significantly less visible to market participants and as less relevant to both institutional investors and corporate managers in the United Kingdom than in the United States. Although influence is a vague concept, the picture in the United Kingdom was consistent with the other evidence:[124] proxy

is much lower than the 25% point impact found in the U.S., but is still material . . . ."). In a recent study of European countries, including the United Kingdom, Professor Joerg-Markus Hitz and Doctor Nico Lehmann conclude that "the association between [proxy advisory firms'] recommendations and voting outcomes is considerably lower in economic terms [in Europe] than that documented in prior U.S. studies." Joerg-Markus Hitz & Nico Lehmann, *Empirical Evidence on the Role of Proxy Advisory Firms in European Capital Markets*, 27 EUR. ACCT. REV. 713, 716, 733 (2017). The study did not treat the United Kingdom distinctly for relevant purposes.

[120] Harry Coghill, *Activism: 10 Key Differences Between the U.S. and the U.K.*, MACFARLANES (Mar. 12, 2015), https://www.macfarlanes.com/insights/2015/activism-10-key-differences-between-the-us-and-the-UK/. Another U.K.-based firm has observed that "ISS and other US proxy advisers are far less influential in Europe." *See Shareholder Activism Nosedives in Europe but Surges in U.S. in 2014*, FRESHFIELDS BRUCKHAUS DERINGER (Jan. 1, 2015), http://news.freshfields.com/en/Global/r/2215/shareholder_ activism_nosedives_in _europe_but_surges_in_us [https://perma.cc/U9S9-7CT4].

[121] *See* Arthur F. Golden et al., Davis Polk & Wardwell LLP, *United States*, *in* GETTING THE DEAL THROUGH: SHAREHOLDER ACTIVISM & ENGAGEMENT 88, 88 (2018), https://www.baerkarrer.ch/publications/Shareholder-activism-engagement-2018.pdf [https://perma.cc/CJ2V-NF AE] (making numerous references to proxy advisory firms).

[122] *See* Will Pearce & Fiona Tregeagle, Davis Polk & Wardwell LLP, *United Kingdom*, *in* GETTING THE DEAL THROUGH: SHAREHOLDER ACTIVISM & ENGAGEMENT, *supra* note 121, at 82 (referring to ISS, among other proxy advisory firms *and trade groups*, but noting that these representative bodies' "guidelines carry significant influence in practice").

[123] These interviews were pre-arranged and conducted by telephone in 2018 and early 2019. I undertook not to directly quote sources or attribute specific comments to them. Some sources expressed no views on particular questions. Some chose not to be identified. Some of those individuals identified in this Article did not participate in interviews, but provided background information.

[124] *See supra* notes 119-122 and accompanying text.

advisors exercise less influence over institutional investors and corporate managers than in the United States. Capturing the general sentiment, one source referred to proxy advisors as part of the "mood music" for institutional shareholders' engagement with boards in the United Kingdom. Several said that proxy advisors in the United Kingdom were yet to command as much influence as institutional investor trade groups. The evidence did not suggest that proxy advisors exert weak influence in the United Kingdom, only that their influence is significantly weaker than in the United States.[125]

II. UNCONVENTIONAL EXPLANATIONS AND DEEPER U.S.-U.K. COMPARISONS

Why this difference in the influence proxy advisors seem to wield, when we would expect a similar role for them in both systems based on the presence of the oft-cited explanatory factors examined in Part I? This Part deepens the comparison between the United States and United Kingdom, identifying four reasons for the differential in influence across systems.

A. *Coordination Mechanisms*

In the United Kingdom, institutional investor trade groups have been a longstanding feature of the governance landscape. These groups have coordinated institutional investors' activities; engaged directly with portfolio companies to effect operational and governance changes; gathered, assessed, and shared information with members; issued voting guidelines and other policies; provided fora for members to meet and collaborate; and advocated on policy issues affecting their members. By undertaking key roles that proxy advisors perform in the United States, U.K. trade groups have left less need for and space available for proxy advisors in the United Kingdom, reducing their potential influence. At the same time, U.S. proxy advisors have coordinated institutional investors' activities, performing functions that trade groups have performed in the United Kingdom, without competition from strong trade groups.

This is not to say that institutional investors in the United Kingdom have provided strong oversight of their portfolio companies. Although their oversight may compare favorably to that of their U.S. counterparts, they have been regarded as too passive.[126] Rather, the claim concerns differences in the roles of trade associations across systems, the reduced capacity this has left for proxy

[125] In fact, proxy advisory firm influence in the United Kingdom has been described as "material." *See* PwC, *supra* note 119, at 3.

[126] *See* CHEFFINS, *supra* note 67, at 373-77 (describing passivity by institutional shareholders since World War II); SIR DAVID WALKER, A REVIEW OF CORPORATE GOVERNANCE IN UK BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES: FINAL RECOMMENDATIONS 71 (2009) (criticizing institutional investors in the wake of the Financial Crisis of 2008 for, among other things, having acquiesced in banks' risk-taking).

advisors to exert influence in the United Kingdom, and the extent to which proxy advisors serve as functional substitutes for investor trade groups.

Institutional investors face collective action problems, but have incentives to coordinate their stewardship efforts through formal networks such as trade groups.[127] By acting through trade groups, institutional investors avoid the direct costs of engagement (sharing them instead with other group members) and mitigate the business conflicts they may face by opposing corporate managers that are clients, or potential clients, of another arm of their business.[128]

In the United Kingdom, each major category of institutional investor established a trade group. The Association of British Insurers ("ABI"), formed in 1933, acted for insurers; the National Association of Pension Funds ("NAPF"), formed in 1963, acted for pension funds; and the Association of Investment Trust Companies ("AITC"), formed in 1932, and the Association of Unit Trusts and Investment Funds ("AUTIF"), formed in 1959, acted for mutual funds.[129] These groups shared expenses and exposure, with "no single [institution] bear[ing] all the risk or the notoriety of action that is in the interest of all."[130]

Trade groups helped coordinate their members' activities at the level of individual portfolio companies, influencing managers' decisions about company-specific matters, as well as at the industry-wide level, influencing policies affecting all companies. We know less about the scale of trade groups' activities at the individual company level because they were mostly non-public, and yet interventions occurred that achieved changes in portfolio companies' business and operational policies.[131] The ABI and NAPF were regarded as most active in this domain.[132] A description from 1980 explains how trade groups coordinated their members' activities through so-called "case committees."[133]

[127] *See* Luca Enriques & Alessandro Romano, *Institutional Investor Voting Behavior: A Network Theory Perspective*, 2019 U. ILL. L. REV. 223, 245-46, 254-57 (using network theory to help explain when institutional investors will cooperate with one another by gathering information to cast informed votes when we would expect them not to do so based on rational reticence). In this Article, I regard coordination as encompassing not only cooperation (in the sense used by Professors Enriques and Romano), but also actions by trade groups gathering and assessing information for their members, advocating for members in public fora, making voting recommendations, and engaging directly with portfolio company managers to represent members' views.

[128] *See* Paul Davies, *Shareholders in the United Kingdom*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER, *supra* note 24, at 369.

[129] *See* STAPLEDON, *supra* note 56, at 49-51.

[130] Louis Lowenstein & Ira M. Millstein, Forum, *The American Corporation and the Institutional Investor: Are There Lessons from Abroad?*, 1988 COLUM. BUS. L. REV. 739, 748 (quoting Letter from Robert A.G. Monks, Institutional S'holder Servs., to Ira M. Millstein, Esq. (Nov. 4, 1987)).

[131] Paul L. Davies, *Institutional Investors in the United Kingdom*, *in* INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE 257, 277-78 (Theodor Baums et al. eds., 1993).

[132] *See* STAPLEDON, *supra* note 56, at 135-38.

[133] *See* COMM. TO REVIEW THE FUNCTIONING OF FIN. INSTS., *supra* note 45, at 252-53, 256.

When governance issues arose in an individual company, trade groups set up case committees comprising representatives from their members with significant shareholdings in that company.[134] When committees sought to influence managers' decisions, they did so nonpublicly. When committees made voting recommendations, parent trade groups communicated them to members.[135]

At the industry-wide level, investor trade groups influenced governance practices.[136] Some groups provided information to their members in reports somewhat akin to modern proxy advisors' voting guidelines. For example, in the early 1990s, the ABI and NAPF published information about upcoming meetings of the largest public companies; these reports identified contentious matters and whether individual companies met governance best practices, without making recommendations.[137] Together, trade groups were influential in crafting rules on various governance issues, including pro-shareholder takeover rules.[138] They also succeeded in discouraging public companies from issuing non-voting shares.[139]

Institutional investor trade groups also acted collectively through the ISC.[140] Formed in 1973 by trade groups after prodding by the Bank of England, the ISC acted as an umbrella organization to "coordinate and extend the existing investment protection activities of institutional investors with a view, where this is judged necessary, to stimulating action by industrial and commercial companies to improve efficiency."[141] In prodding institutional investors, the Bank of England is said to have acted on the initiative of the government, which wanted institutional investors more actively to oversee corporate managers.[142] In its early years, the ISC oversaw corporate managers at individual companies. In the late 1980s it shifted focus from the portfolio-company level to the industry-wide level, developing standards of best practice on corporate governance.[143]

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[134] *See id.* at 253.

[135] *See* STAPLEDON, *supra* note 56, at 135.

[136] *See* Davies, *supra* note 128, at 355, 362, 365-67 ("[T]he influence [by institutional investors] was exercised predominantly through the trade associations which they had established, in particular the Association of British Insurers and the National Association of Pension Funds.").

[137] *See* STAPLEDON, *supra* note 56, at 98-99.

[138] Armour & Skeel, Jr., *supra* note 66, at 1767-75.

[139] *See* CHEFFINS, *supra* note 67, at 375.

[140] *See supra* note 88 and accompanying text.

[141] *See* COMM. TO REVIEW THE FUNCTIONING OF FIN. INSTS., *supra* note 45, at 253 (quoting the ISC's terms of reference). In 2011, the ISC was reconstituted as the Institutional Investor Committee.

[142] STAPLEDON, *supra* note 56, at 51-52.

[143] *Id.* at 52-53; Black & Coffee, Jr., *supra* note 45, at 2019-21. In 1991, the ISC issued best practice guidelines: INSTITUTIONAL S'HOLDERS COMM., THE RESPONSIBILITIES OF INSTITUTIONAL SHAREHOLDERS IN THE UK (1991), and INSTUTIONAL S'HOLDERS COMM., THE ROLE AND DUTIES OF DIRECTORS – A STATEMENT OF BEST PRACTICE (1991).

Trade groups remain active in U.K. corporate affairs. The NAPF, now known as the Pension and Lifetime Savings Association ("PLSA"), continues to operate, as does the AITC, which is now known as the Association of Investment Companies ("AIC"). The PLSA "regularly engage[s]" with its members' portfolio companies;[144] it also helps them organize case committees so members can engage with portfolio companies themselves.[145] Its engagements are confidential.[146] Each year the PLSA publishes guidelines outlining its approach to general governance issues, much like the annual proxy voting guidelines of proxy advisors.[147] The Investment Association, the product of a merger between the AUTIF and the investment affairs division of the ABI,[148] assists members with proxy voting.[149] Its Institutional Voting Information Service ("IVIS") provides guidance on governance issues, color-coding its reports according to the severity of its concerns on the relevant issue.[150] Its guidance is highly visible.[151] Trade groups continue to give institutional investors a voice on governance issues.[152] They represent their members before government-

[144] *Engaging with Companies*, PENSIONS & LIFETIME SAVINGS ASS'N, https://www.plsa.co.uk/Policy-and-Research-Stewardship-Engaging-with-companies [https://perma.cc/FR25-9NL4] (last visited Apr. 13, 2019).

[145] *Id.* ("We also help members by organising Case Committees through which specific company problems can be addressed directly with Boards on a confidential basis.").

[146] *Id.*

[147] *See, e.g.*, PENSIONS & LIFETIME SAV. ASS'N, CORPORATE GOVERNANCE POLICY AND VOTING GUIDELINES 10-12 (Jan. 2019), https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2019/CG_Voting%20Guidelines%202019%20FINAL.pdf [https://perma.cc/QHF4-9AC8]. In its U.K. and Ireland Proxy Voting Guidelines, ISS discloses that it used the PSLA's guidelines as its "standard reference" until 2015 and since then its guidelines have "remain[ed] broadly consistent with those of the [PLSA]." INSTITUTIONAL S'HOLDER SERVS., UNITED KINGDOM AND IRELAND PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 4 (Dec. 6, 2018), https://www.issgovernance.com/file/policy/latest/emea/UK-and-Ireland-Proxy-Voting-Guidelines.pdf [https://perma.cc/UG9K-XM2R].

[148] *See History of the Investment Association*, INVESTMENT ASS'N, https://www.theinvestmentassociation.org/about-the-investment-association/history-of-the-investment-associaton.html [https://perma.cc/XGP7-WSBK] (last visited Apr. 13, 2019).

[149] THE INVESTMENT ASS'N, *supra* note 49, at 11 ("The [Investment Association's] corporate governance research service IVIS helped guide subscribers through the AGM season.").

[150] *About*, INSTITUTIONAL VOTING INFO. SERV., https://www.ivis.co.uk/about-ivis/ [https://perma.cc/FT2S-EY73] (last visited May 9, 2019) (describing features of IVIS).

[151] According to Professor Brian Cheffins, IVIS's guidance to its subscribers "gets quite a bit of media attention. . . . Institutional investors operating in the UK likely are less inclined to rely on proxy advisors than their American counterparts given they can draw readily upon recommendations from an organization operating under the auspices of a well-known and respected trade association." Email Communication with Brian R. Cheffins (Apr. 5, 2019).

[152] David Kershaw, *Corporate Law and Self-Regulation*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 869, 900 (J.N. Gordon & W. Ringe eds., 2018) ("[I]t is clearly the case that for the past two decades institutional investors themselves, and via their trade associations, have exerted a strong public governance voice in the UK.").

commissioned inquiries, which are a regular feature of the U.K. corporate governance landscape. They give input to the Financial Reporting Council on updates to the Stewardship Code. They perform a similar role for updates to the U.K. Corporate Governance Code ("Corporate Governance Code"), which is a set of governance best practices published by the Financial Reporting Council for companies with a premium listing on the London Stock Exchange.[153]

U.K. trade groups can be seen to exert influence over institutional investors and corporate boards, diminishing the need and space for proxy advisors. For example, until 2015, ISS used the PLSA's policy and voting guidelines as their "standard reference" for the United Kingdom rather than having "standalone" policies.[154] Since 2015, ISS's U.K. proxy voting guidelines have been "broadly consistent" with those of the PLSA[155] and have drawn from various codes and guidelines issued by other trade groups.[156] This is the case despite ISS's status as one of the most visible proxy advisors in the United Kingdom.[157] In its U.K. voting guidelines, proxy advisor Glass Lewis uses the Investment Association's guidelines as its benchmark, reviewing the extent to which companies adhere to the Investment Association's principles.[158] In explaining its approach, Glass Lewis observes that the Investment Association has "heavily influenced" best practices in the United Kingdom.[159]

One recent U.K. innovation is the Investor Forum, a trade group intended to intervene on behalf of institutional investors at the level of portfolio companies. Formed in 2014, the Investor Forum arose out of recommendations by the government-initiated Kay Review in 2012, a review that considered institutional investors' disincentives to engage with their portfolio companies.[160] In response

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153 *See* FIN. CONDUCT AUTH., FINANCIAL CONDUCT AUTHORITY HANDBOOK, Listing Rule 9.8.6 (2019) (U.K.) [hereinafter FCA HANDBOOK], https://www.handbook.fca.org.uk/handbook [https://perma.cc/LHJ6-HWQK]; FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE (2018) [hereinafter CORPORATE GOVERNANCE CODE], https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf [https://perma.cc/2945-HJX5].

154 *See* INSTITUTIONAL S'HOLDER SERVS., *supra* note 147, at 4.

155 *Id.*

156 *See id.* at 4, 34.

157 *See* Pearce & Tregeagle, *supra* note 122, at 82 (describing voting guidelines issued by institutional investor trade groups and by proxy advisors in the United Kingdom and naming only ISS as a firm in the latter group).

158 GLASS LEWIS, 2019 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE: UNITED KINGDOM 1 (2019), http://www.glasslewis.com/wp-content/uploads/2018/11/2019_GUIDELINES_United-Kingdom.pdf [https://perma.cc/8BM3-69ZT] ("Glass Lewis will therefore review companies' adherence to the Investment Association's principles.").

159 *Id.*; *see also id.* at 29 ("The [Investment Association] serves as one of the primary drivers of remuneration best practices in the UK.").

160 KAY, *supra* note 50, at 9-11. The Review proposed to "[a]ddress the disincentives to engagement by asset managers with investee companies that arise from fragmented shareholding and the perceived regulatory barriers that inhibit collective engagement, by

to these recommendations, representatives of institutional investors formed a working group to consider such a forum and attracted wide interest, membership, and funding from institutional investors.[161]

The Investor Forum's executive group engages with corporate managers on behalf of its members, based on proposals members or corporate managers bring to the executive.[162] If the executive proceeds with an engagement, it will communicate, typically on a bilateral basis, with its members that hold stock in the relevant company and wish to participate in the engagement, in order to formulate an engagement strategy. The executive develops a strategy that is "intended to impartially describe the range of [its participating members'] views, but does not seek to form agreement between Members, in particular in relation to their investment or voting decisions,"[163] which lessens the risk of triggering disclosure rules concerning shareholder groups seeking to exercise influence over corporate managers. The executive then engages with the company's managers to execute their strategy. In interviews, market participants observed that the Investor Forum is becoming a prevalent feature of U.K. corporate life, having been involved in major engagements. Since its inception, the Investor Forum has engaged with twenty-three U.K. companies, including Rolls-Royce, Royal Dutch Shell/BG Group, and Standard Chartered.[164]

As for the United States, trade groups have played less significant and less visible roles in coordinating the stewardship efforts of institutional investors than have their U.K. counterparts. Established by the head of a public pension fund,[165] the U.S. Council of Institutional Investors ("CII") may be the closest counterpart to the U.K. trade bodies, but is of more recent origin, having been formed in 1985 to act for public, corporate, and union pension funds.[166] The CII issues reports on an ad hoc basis, covering certain governance issues such as

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establishing an investors' forum for institutional investors in UK companies." *See id.* at 9. Among other things, it recommended that "[a]n investors' forum should be established to facilitate collective engagement by investors in UK companies." *Id.* at 13.

[161] In 2018, the Investor Forum's members represented approximately 30% of the FTSE All-Share market capitalization, having approximately £17 trillion under management globally. *See* INV'R FORUM, REVIEW 2018, at 6 (Jan. 30, 2019), https://www.investorforum.org.uk/wp-content/uploads/2019/01/Annual_Review_2018.pdf [https://perma.cc/XM5N-2YEC].

[162] *See* INV'R FORUM, COLLECTIVE ENGAGEMENT FRAMEWORK 5-7 (Oct. 18, 2016), https://www.investorforum.org.uk/wp-content/uploads/2018/08/Collective-Engagement-Framework-Summary.pdf [https://perma.cc/Y7NB-ZMXX].

[163] *Id*. at 6.

[164] *Id*. at 2; Pearce & Tregeagle, *supra* note 122, at 86-87.

[165] For a discussion of the CII's origins, see Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 479-81 (1990). For an example of its recent lobbying activities, see DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON 55-56 (2018) (describing CII's lobbying for proxy access).

[166] *See* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 573 (1990).

proxy access and compensation, and has identified underperforming companies in its "focus list," but would seem to have exerted significantly less influence on the U.S. corporate governance landscape than its U.K. counterparts have in the United Kingdom. Visible counterparts for other categories of institutional investors have not arisen. No U.S. trade group has published voting guidelines obviating the need for standalone proxy voting guidelines, as in the United Kingdom. Nor has any trade group shaped widely accepted best practice governance principles as successfully as U.K. trade groups. The Investor Forum has no U.S. counterpart. Studies of the institutional investor landscape regularly refer to trade bodies in the United Kingdom but not in the United States.[167]

Recent signs suggest increasing coordination by U.S. institutional investors at a market-wide level, which may mitigate the influence of proxy advisors. The Investment Stewardship Group ("ISG") produced Corporate Governance Principles and Stewardship Principles that took effect on January 1, 2018.[168] Formed by major institutional investors, the ISG's members include BlackRock, State Street Global Advisors, and Vanguard, the "Big Three."[169] Its governance and stewardship principles broadly resemble the Corporate Governance Code and Stewardship Code, respectively, in their coverage of issues but with less detail (and apparently without input from corporate managers).[170] This initiative would seem to underscore the absence of strong trade groups or similar representative bodies in the United States relative to the United Kingdom.

The task of coordinating institutional investors in the United States has been left largely to proxy advisors, especially ISS.[171] Although ISS is not, and has

[167] *Compare* Black & Coffee, Jr., *supra* note 45, at 2018-19 (examining institutional investors' trade groups in the United Kingdom), *with* Edward B. Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE *supra* note 152, at 363 (focusing on U.S. institutional investor landscape without mentioning trade groups). *See also supra* notes 121-122 and accompanying text.

[168] *See About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance*, INVESTOR STEWARDSHIP GROUP, www.isgframework.org [https://perma.cc/7Q2L-6GVR] (last visited Apr. 13, 2019) (describing history and function of ISG).

[169] *Id*.

[170] As to differences between the Stewardship Code and its U.S. counterpart, see Jennifer G. Hill, *Good Activist/Bad Activist: The Rise of International Stewardship Codes*, 41 SEATTLE U. L. REV. 497, 521-23 (2018).

[171] *See* Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *Passive Investors* 25 (ECGI Law Working Paper No. 414/2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3192069 (describing proxy advisory firms' role in helping institutional investors to "aggregate preferences and overcome collective action problems"); Sharon Hannes, *Super Hedge Fund*, 40 DEL. J. CORP. L. 163, 199 (2015) (describing proxy advisors as "well geared" for "[c]oordinating the actions of many different institutional investors"); Randall S. Thomas, Alan R. Palmiter & James F. Cotter, *Dodd-Frank's Say on Pay: Will It Lead to a Greater Role for Shareholders in Corporate Governance*, 97 CORNELL L. REV. 1213, 1231-32 (2012) ("ISS . . . may serve the purpose of helping shareholders . . . collectivize and use their voting power in a coordinated way."). In recent years, the task of coordinating institutional investors has also been undertaken by activist hedge funds.

never been, a formal trade body with institutional investors as its members,[172] it functions similarly to U.K. trade bodies in key respects. It gathers and assesses information about portfolio companies and institutional investors' preferences, issuing proxy voting guidelines that incorporate that information while also reflecting institutions' preferences. It also often advocates for institutional investors.

Proxy advisors differ in some respects from trade groups. Proxy advisors issue company-specific recommendations, giving institutional investors more explicit voting guidance than U.K. trade groups tend to do. Unlike trade groups, they tend not to engage with portfolio companies on behalf of institutional investors to force change on operational or governance issues. Rather, for a fee, some proxy advisors advise portfolio companies on governance issues, creating conflicts of interest that may put them at cross-purposes with institutions.[173] And since they are not member organizations, proxy advisors generally provide no fora to facilitate connections or collaboration among institutional investors.

In sum, U.K. institutional investors have benefited from significantly stronger institutional investor trade groups than their U.S. counterparts. These groups have coordinated institutional investors, collectivizing their voting power and diminishing the need for and space available for proxy advisors in the United Kingdom. In the United States, proxy advisors perform key roles that investor trade groups undertake in the United Kingdom, serving as functional substitutes for trade groups to an important extent and giving them greater influence than they have in the United Kingdom.

Finally, several explanations suggest themselves for trade groups' relatively weak role in the United States. First, U.K. trade groups formed when U.K. institutional investors were largely based in London and Edinburgh, in close geographic proximity with one another.[174] Of course, British corporate shareholdings have changed significantly, as discussed later.[175] But major trade

[172] ISS was formed around 1988 by Robert Monks, former administrator of the Office of Pension and Welfare Benefit Programs at the Department of Labor. Today it is owned by a private equity firm. *See* Nikhil Subba & Diptendu Lahiri, *Genstar Capital to Buy Proxy Advisory Firm ISS for $720 Million*, REUTERS (Sept. 7, 2017, 10:54 AM), https://www.reuters.com/article/us-institutional-shareholder-services-m/genstar-capital-to-buy-proxy-advisory-firm-iss-for-720-million-idUSKCN1BI20C [https://perma.cc/4EHH-Y8BX].

[173] For example, "ISS advises institutional investors on how to vote proxies and provides consulting services through its subsidiary, ISS Corporate Solutions, Inc., to companies seeking to improve their corporate governance." U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 33.

[174] *See* CHEFFINS, *supra* note 67, at 372 ("[M]ost British institutional investors, including fund managers, have traditionally been based within a small area in the City of London or in Scotland's financial capital of Edinburgh . . . .").

[175] See *infra* notes 256-268 and accompanying text. Today investors are spread across the globe, with foreign investors—mostly institutions—holding more than half of U.K. public companies' shares. *See* OFFICE FOR NAT'L STATISTICS, *supra* note 65 (showing increase in foreign shareholders of U.K. public companies in recent decades). The internationalization of

groups emerged from the 1930s to the 1960s,[176] when British companies' shareholders were overwhelmingly domestic and becoming increasingly institutional. Close geographic proximity brought investors into contact with one another, allowing regular communication, reducing coordination costs and facilitating the rise of trade groups.[177] In contrast, U.S. institutional investors were (and still are) geographically remote from one another, spread across a vastly larger country and lacking cohesion.[178]

Second, U.K. trade groups are strong relative to their U.S. equivalents because the U.K. government actively encouraged U.K. institutional investors to oversee corporate managers through public inquiries and reviews and other measures, more fully described below.[179] Finally, U.K. institutional investors benefited from stronger shareholder rights and fewer legal obstacles to coordinating their stewardship actions than their U.S. counterparts, as discussed further below,[180] increasing their incentives to act collectively and to form representative bodies to steward their portfolio companies.

B. *Unresolved Governance Questions*

A second difference that bears on the influence of proxy advisors concerns the proposals or resolutions on which shareholders may need to vote. Relative to their U.K. counterparts, U.S. institutional investors face more unresolved governance questions, conditions that create incentives for institutional investors to use proxy advisors, in turn giving proxy advisors greater potential influence.

In the United Kingdom, "[t]here is no single, tidy statement of shareholder rights,"[181] but governance questions tend to be more settled than they are in the United States. In addition to legislation, case law, listing rules, and companies' articles of association, which specify shareholders' rights, the Corporate Governance Code establishes what market participants generally regard as best practice governance arrangements. Compared with the American position, the

British companies' shareholder bases is relatively recent, having begun in the late 1980s when foreign holdings first crossed 10% and steadily increased. *Id. See also infra* Appendix A, Figures 3-4.

[176] *See supra* note 129 and accompanying text.

[177] *See* Black & Coffee, Jr., *supra* note 45, at 2078 ("U.S. institutions are unlikely to approach the level of concentration or the geographic and cultural cohesion of the City [of London], where contact among institutional investors is constant. . . . [F]or a given level of ownership concentration, the City's geographic and cultural cohesion reduces coordination costs."). Network theory suggests that geographic links among market actors may induce them to cooperate more. *See* Enriques & Romano, *supra* note 127, at 246-47.

[178] *See* Armour & Skeel, Jr., *supra* note 49, at 1791 ("U.S. institutions are still more far-flung than their U.K. counterparts . . . .").

[179] *See infra* Section II.D.

[180] *See infra* Sections II.C., II.D.

[181] Richard C. Nolan, *Shareholder Rights in Britain*, 7 EUR. BUS. ORG. L. REV. 549, 566 (2006).

U.K. regime limits variation in the positions companies take, reducing the cost for institutional investors to make voting decisions.

To illustrate this explanation, consider the most common categories of shareholder proposals that U.S. institutional investors have been called upon to vote on in recent years, as identified by the law firm Wachtell, Lipton, Rosen & Katz.[182] These categories include proxy access, separating the roles of chief executive officer and chair, special meetings/written consent, annual director elections, majority voting, removal of supermajority voting, and one-share-one-vote.[183]

1. Proxy Access

Proxy access refers to whether shareholders may nominate directors for election to the board and use the company's proxy machinery through the right to call meetings, place items on agendas, distribute information statements, and have their positions reflected on corporate ballots or proxy cards. In the United States neither state nor federal law mandates proxy access.[184] U.S. corporate constitutional documents may grant shareholders these rights, and often do, but shareholder proposals attempting to achieve that often face opposition from management.

The U.K. position on proxy access is more generous to shareholders and admits less opposition. Shareholders representing at least 5% of total voting rights and any group of one hundred shareholders may propose resolutions, including resolutions to appoint or remove directors, at an annual general meeting ("AGM").[185] These provisions are shareholder-friendly as the hundred-shareholder requirement may be satisfied by a single shareholder with less than

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[182] Trevor S. Norwitz et al., Watchell, Lipton, Rosen & Katz, *Market Trends: Shareholder Proposals*, LEXISNEXIS PRAC. ADVISOR J. (Feb. 28, 2018), https://www.lexisnexis.com/lexis-practice-advisor/the-journal/b/lpa/archive/2018/02/28/market-trends-shareholder-proposals.aspx [https://perma.cc/6U4P-7C9T] (identifying twelve common categories of shareholder proposals). I exclude catch-all categories "Other social issues" and "Miscellaneous" as identified in the memorandum because of their generality. *See id*.

[183] *See id.*

[184] *See* Golden et al., *supra* note 121 ("Companies are not required by state or federal law to permit shareholders to nominate directors for election to the board and use the company's proxy infrastructure, at the company's expense, to do so (ie, proxy access is not legally mandated)."). For a detailed study of the desirability of proxy access, see Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329 (2010).

[185] Companies Act 2006, c. 46, § 338 (permitting shareholders to propose resolutions at AGMs of public companies). As to resolutions to appoint directors, default articles give shareholders authority to appoint directors. *See* Model Articles for Public Companies, Art. 20 (U.K.). Companies may draft their own articles, imposing notice and other requirements on shareholders proposing to appoint candidates. *See* DAVIES & WORTHINGTON, *supra* note 53, at 367-68; Pearce & Tregeagle, *supra* note 122, at 83. Legislation gives shareholders the right to remove directors by ordinary resolution, which requires 50% approval of those shareholders voting. *See* Companies Act 2006, c. 46, § 168.

5% of total voting rights "splitting its shares between nominee accounts."[186] Shareholders may include a statement of up to one thousand words supporting their resolution.[187] Provided shareholders comply with certain notice requirements, the company bears the cost of circulating this information.[188] The company is also required to circulate the resolution to shareholders and (provided shareholders satisfy certain notice requirements) pay the expenses of doing so.[189] In practice, the company uses a single proxy card that includes shareholders' resolutions, giving shareholders access to the corporate ballot.[190]

Separately, shareholders representing at least 5% of total voting rights may requisition a (special) general meeting, to be held at the company's expense, and propose a resolution for adoption.[191] Shareholders bear the costs of circulating statements for resolutions at these meetings, unless the company decides otherwise.[192] Again, a single proxy card is used.[193]

2. Separation of Chief Executive and Chair

In U.S. public companies it is not unusual to find the same individual occupying the roles of both chair and chief executive. No consensus exists on whether these positions should be separated. Neither state nor federal legislation expresses a position.

The U.K. position on the separation of the roles of chair and chief executive is more certain. While the Companies Act 2006 contains no provision on the matter, the Corporate Governance Code suggests that the chair and CEO roles should be occupied by different individuals.[194] While nonbinding, the Corporate Governance Code is more than simply "soft law" since listed companies are required to disclose whether they comply with the code, and if they do not, to explain why.[195] Companies could satisfy their obligation by explaining their noncompliance, and yet they tend to comply; the code is "highly influential."[196]

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[186] Pearce & Tregeagle, *supra* note 122, at 83.

[187] Companies Act 2006, c. 46, § 314.

[188] *See id.* §§ 314-17.

[189] *Id*. § 339-40.

[190] Lucian A. Bebchuk, *Shareholder Rights and the DGCL*, DEL. LAW., Spring 2008, at 16 ("[T]he corporate law codes of the United Kingdom and other common-law countries grant shareholders with a sufficient stake the right to place director candidates on the corporate ballot.").

[191] *See* Companies Act 2006, c. 46, §§ 303-05 (Eng.).

[192] *See id.* §§ 316.

[193] *See* Bebchuk, *supra* note 190, at 16.

[194] CORPORATE GOVERNANCE CODE, *supra* note 153, at 6. The Corporate Governance Code applies to companies whether incorporated in the U.K. or elsewhere.

[195] DAVIES & WORTHINGTON, *supra* note 53, at 397; *see also* FCA HANDBOOK, *supra* note 153, Listing Rules 9.8.6 to 7A.

[196] MOORE & PETRIN, *supra* note 44, at 50 ("[T]he UK Corporate Governance Code . . . is in practice a highly influential and respected regulatory instrument which public issuers ignore at their peril."); *see also* DAVIES & WORTHINGTON, *supra* note 53, at 399 (describing

In any case, the Corporate Governance Code specifies generally agreed upon best practices, including on the separation of these roles, thereby reducing the cost for institutional investors when required to take a position on the matter. On this question, U.K. public companies follow the best practice recommendations: they "invariably" separate the roles of chair and chief executive.[197]

3. Special Meetings/Written Consent

As to written consent in lieu of meetings, U.S. law permits this innovation, unless a company's charter provides otherwise;[198] U.K. statutory law contains no such provision, although commentators suggest that informed approval by all shareholders of a resolution will be effective.[199] As to shareholders calling special meetings, the U.S. position depends on a company's charter and bylaws.[200] U.K. law is certain: shareholders representing at least 5% of total voting rights may call a general meeting, at which they may propose resolutions,[201] although for such meetings they must cover the expenses of distributing their information statements.[202]

4. Annual Director Election

In the United States, companies may adopt staggered boards.[203] Commentators contest the desirability of these measures, and staggered boards are losing favor. In the United Kingdom, the model articles of association for public companies prescribed by legislation, which apply by default to public companies, require all directors to retire from office at each AGM,[204] requiring them to seek reelection if they wish to continue. In practice, many companies' articles allowed directors to come up for election on a staggered basis, often every three years. This practice was common until the past decade or so, according to market participants with whom I spoke. However, U.K. law has long allowed shareholders to remove directors at any time, based on a 50%

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the Corporate Governance Code as "exert[ing] a real, although not completely inflexible, pressure on companies to conform to a particular model of board composition and operation").

197 *See Getting a Take Private Off the Ground in the UK*, GIBSON DUNN (Dec. 18, 2018), https://www.gibsondunn.com/getting-a-take-private-off-the-ground-in-the-uk/ [https://perma.cc/R2UY-4GV6] ("In the UK, the role of the Chairman and the CEO are invariably separate roles.").

198 *See, e.g.*, DEL. CODE ANN. tit. 8, § 228 (2019) (permitting shareholders to act by written consent unless company's charter provides otherwise).

199 *See* Pearce & Tregeagle, *supra* note 122, at 83 ("[A] written record of the passing of a resolution, which has been signed by all shareholders of the company in full knowledge of what they are resolving, should be accepted as a valid expression of member approval.").

200 *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(d) (2019) (stating that stockholders meetings are to be held as provided in the charter or bylaws).

201 Companies Act 2006, c. 46, § 303-05 (Eng.).

202 *Id.* § 316.

203 *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(d).

204 *See* Model Articles for Public Companies, Art. 21 (U.K.).

majority vote of shareholders, with or without cause and notwithstanding any agreement to the contrary with the director[205]—a shareholder-friendly term with no U.S. statutory counterpart. Today, the Corporate Governance Code recommends that directors face re-election annually.[206]

5. Majority Voting and One-Share-One-Vote

In the United States, the method of voting in director elections is an issue for a company's charter or bylaws. Again, it is a question on which institutional investors in U.S. companies take diverging positions, although the current trend favors majority voting over plurality voting.[207] In the United Kingdom, legislation requires the appointment of public company directors to be voted on individually,[208] making plurality voting operationally difficult. Also, the U.K. model articles of association for public companies provide for directors to be elected by ordinary resolution, that is, by simple majority;[209] these provisions apply by default to public companies.

6. Supermajority Voting and One-Share-One-Vote

As to supermajority voting and one-share-one-vote, U.S. public companies may and often do have supermajority voting shares and even non-voting shares. In the United Kingdom, corporate law takes a similar approach, allowing companies "to issue shares with no, restricted, or weighted voting rights."[210] But institutional investors have long disfavored disproportionate voting rights and discouraged exceptions to the principle of one-share-one-vote.[211] Accordingly,

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[205] Companies Act 2006, c. 46, § 168 (Eng.).

[206] CORPORATE GOVERNANCE CODE, *supra* note 153, at 8 ("All directors should be subject to annual re-election."). This provision applies to FTSE 350 companies.

[207] Among S&P 100 companies, the proportion of companies adopting majority voting has increased from 10% in 2004 to 95% in 2018. *See* David A. Bell, *Corporate Governance Survey: 2018 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 22, 2019), https://corpgov.law.harvard.edu/2019/01/22/corporate-governance-survey-2018-proxy-season/ [https://perma.cc/2TE3-KHW9].

[208] Companies Act 2006, c. 46, § 160 (Eng.).

[209] *See* Model Articles for Public Companies, Art. 20 (U.K.). As to ordinary resolutions, see Companies Act 2006, c. 46, §§ 282, 283 (Eng.). If voting is by poll, the majority requirement applies to the votes attaching to shares that are cast; however, if voting is by show of hands, the majority requirement applies to those who vote (without reference to the number of votes they hold). *See* DAVIES & WORTHINGTON, *supra* note 53, at 426-28. Although voting by show of hands might distort voting results, that possibility is severely mitigated by various measures not explored here, as to which see *id*. at 448-50. In any case, routine practice for public companies appears to be voting by poll, meaning that resolutions require a simple majority of votes cast.

[210] DAVIES & WORTHINGTON, *supra* note 53, at 791.

[211] *Id*. ("[I]nstitutional investors have traditionally been reluctant to buy shares whose votes do not reflect the financial risk.").

companies rarely depart from that principle.[212] In 2014, the Financial Conduct Authority prohibited disproportionate voting arrangements for companies with a premium listing, the category most comparable to public company listing in the United States.[213]

7. Poison Pills

In the United States, corporate boards may adopt "poison pills" or shareholders' rights plans. Under U.K. law, however, these arrangements, if adopted, would probably breach directors' fiduciary duties and therefore be regarded as impermissible; they are not a feature of the U.K. corporate governance landscape.[214]

8. Other Issues

On a broad range of other matters, the Corporate Governance Code states best practice arrangements. Sponsored by the Financial Reporting Council, it covers matters including board leadership, remuneration, accountability, and relations with shareholders.[215] It is updated periodically following a process of consultation with a range of industry participants, including institutional investors, corporate managers, and trade groups. The Corporate Governance Code provides that the board's role is "to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society."[216] It provides that, in addition to formal shareholder meetings, board chairs should regularly engage with major shareholders and with shareholders generally on significant matters, and that boards should clearly understand shareholder views.[217] Similarly, when at least 20% of votes cast oppose a board-recommended resolution, the company should explain when announcing the voting results how it will gather feedback on the question; within six months, update shareholders on the shareholder feedback received; and

[212] MOORE & PETRIN, *supra* note 44, at 84-85 ("[E]ven for companies that are allowed to use disproportionate voting, the practice is rare in the UK given investor pressures against such structures.").

[213] *See* FCA HANDBOOK, *supra* note 153, Listing Rule 7.2.1A. *See also* HONG KONG STOCK EXCH., RESEARCH REPORT: LISTING REGIME REFORMS FOR DUAL CLASS SHARE STRUCTURE AND BIOTECH INDUSTRY 5 (Nov. 2018), https://www.hkex.co m.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2018/CCEO _DualClass_201811_e.pdf?la=en [https://perma.cc/23TC-VKU9] ("Unlike the US, the UK currently allows only some sections of its market to list companies with a DCS [dual class share] structure. For Premium Listing . . . issuers have to comply with super-equivalent rules on information disclosure."). The alternative listing in the U.K. is a standard listing, the rules for which do permit disproportionate voting arrangements. *Id.*

[214] *See* Pearce & Tregeagle, *supra* note 122, at 84.

[215] *See* CORPORATE GOVERNANCE CODE, *supra* note 153.

[216] *Id.* at 4.

[217] *Id.* (stating in provision 3 that boards should engage with shareholders).

thereafter explain in its annual report how that feedback affected its decision.[218] The board should understand the views of non-shareholder stakeholders and explain in its annual report "how their interests . . . have been considered in board discussions and decision-making."[219]

The Corporate Governance Code also provides guidance for boards and shareholders on remuneration. For instance, it states that share awards granted to align executive directors' interests with those of long-term shareholders should be released for sale on a phased basis and have a vesting and holding period of at least five years.[220] Under the Corporate Governance Code, notice and contract periods for executive directors should be no longer than one year.[221]

By narrowing the range of issues on which institutional investors must vote and providing ready answers for many issues on which they may vote, the U.K. regime reduces the need for proxy advisors. In fact, in their U.K. proxy voting guidelines, proxy advisors treat the Corporate Governance Code as authoritative. In its U.K. proxy voting guidelines, ISS "follows the [Code's] guidance,"[222] limiting the new information and advice it offers and therefore the influence it can exert. Recall that until 2015, ISS also used a U.K. trade group's guidelines as the standard reference for its proxy voting guidelines.[223] For its part, Glass Lewis observes that "[c]orporate governance guidelines in the UK are primarily based on the UK Corporate Governance Code" and that its own voting guidelines "incorporate" the code's provisions.[224]

The analysis here does not suggest that the U.K. regime is ideal. In fact, the Financial Reporting Council may soon be replaced by a "new, stronger" regulator.[225] The point is that the U.K. regime significantly narrows the range of governance questions on which dispute can arise relative to the U.S. position. If U.K. law makes no provision on a question, the Corporate Governance Code often does, diminishing incentives for institutional investors to seek third-party information and recommendations, in turn reducing demand for these services.

C. *Strength of Shareholder Rights*

Section II.B reviewed the two systems' respective rules concerning several issues in order to illustrate ways in which governance issues are more often

[218] *Id.* at 5 (discussing in provision 4 what companies should do when at least 20% of votes have been cast against board recommendation).

[219] *Id.* (describing in provision 5 board's engagement mechanisms with other key stakeholders).

[220] *Id.* at 14 (discussing in provision 36 purpose of remuneration schemes).

[221] *Id.* (noting in provision 39 that notice or contract periods should be one year or less).

[222] INSTITUTIONAL S'HOLDER SERVS., *supra* note 154, at 4.

[223] *See supra* note 154 and accompanying text.

[224] GLASS LEWIS, *supra* note 158, at 1.

[225] *See* DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY, INDEPENDENT REVIEW OF THE FINANCIAL REPORTING COUNCIL: INITIAL CONSULTATION ON THE RECOMMENDATIONS 13 (2019).

unresolved in the United States. As is evident from the discussion, relative to U.S. law, U.K. law generally affords shareholders stronger rights, giving them greater ability to hold managers accountable. By statute, U.K. shareholders may propose resolutions at AGMs, call special meetings, and have somewhat broader access than U.S. shareholders to the corporate proxy machinery. Through the Corporate Governance Code, the U.K. regime separates the chief executive and chair functions, potentially increasing the board's responsiveness to shareholder concerns. U.K. law does not permit U.S.-style staggered boards. Although U.K. directors may serve multiple-year terms, the Corporate Governance Code recommends annual elections for the largest public companies, and legislation allows shareholders to remove corporate directors without cause. Dual-class companies are ineligible for premium-listing on the London Stock Exchange.

On a range of other issues, U.K. shareholders enjoy stronger rights and protections than their U.S. counterparts. U.K. shareholders can initiate changes to the corporate constitution;[226] U.S. shareholders have no such right.[227] U.K. law has shareholder-friendly takeover rules that restrict defensive tactics, including poison pills. Interviewees with whom I spoke described the strength of shareholder rights as a salient difference between the systems. U.K. institutional investors can credibly threaten to remove directors unless corporate managers engage with their concerns. Strong shareholder rights create incentives for institutional investors to coordinate their activities and to form trade groups to act on their behalf. U.K. trade groups formed early, growing strong and taking space proxy advisors might otherwise have occupied. In the United States, however, institutional investors lacked strong shareholder rights that would have made them more likely than otherwise to act collectively and to form and act through trade groups. Today much of their concerted action is coordinated by proxy advisors.

D. *The Role of the State*

Finally, the differing role of the State helps explain the differential influence of proxy advisors across systems. In the United States, the federal government has shaped incentives of institutional investors to engage with their portfolio companies. Although federal regulators adopted rules regarded as virtually mandating voting by pension and mutual funds, the federal government created legal barriers chilling stewardship efforts by institutional investors.[228] These

[226] Companies Act 2006, c. 46, § 21 (Eng.). Shareholders would need to pass a special resolution, which requires a 75% majority. *Id*. § 283.

[227] DEL. CODE ANN. tit. 8, § 242(b).

[228] *See* Black, *supra* note 166, at 536-51 (examining federal rules concerning proxy voting, insider trading reporting and liability, and controlling person liability). For more recent consideration of many such rules, see James Cotter, Alan Palmiter & Randall Thomas, Symposium, *ISS Recommendations and Mutual Fund Voting on Proxy Proposals*, 55 VILL. L. REV. 1, 9-10 (2010) and Hannes, *supra* note 171, at 200-03. Not all commentators regard these rules as significant obstacles to coordinated action by institutional investors. Professors Ronald Gilson and Reinier Kraakman examine many of the same rules, asking whether they would prevent the concerted shareholder action required to implement a governance strategy

barriers make institutions less willing to coordinate and, to the extent they do coordinate, more likely to seek the services of third-parties such as proxy advisors than trade groups.

Among the web of U.S. rules that stymie institutional investors' capacity to coordinate in monitoring portfolio companies, the most notable is section 13(d) of the Securities Exchange Act of 1934. For many investors, the regime is so burdensome that it is best avoided. It requires anyone with "beneficial ownership" of more than 5% of a class of equity securities of a company to file, within ten days of hitting that ownership threshold, certain information on Schedule 13D with the SEC.[229] On threat of civil or criminal action, shareholders within the provision must disclose information about their holding, including its size, their sources of funding and purposes in acquiring the securities, as well as itemized data of all their trades in the stock for the sixty-day period ending the time of reporting.[230] Filings must be updated for small changes in holdings,[231] and the data becomes public. The regime also imposes a "group" reporting requirement, forcing institutional investors to report not only their own stock holdings but also those of other shareholders that act with them as members of a "group,"[232] heightening the reporting burden. Conventional wisdom holds that courts are more willing than the statutory language suggests to find that shareholders are acting as a "group."[233]

In consequence, institutions seek to avoid triggering Section 13(d), including its "group" concept. Professor John Morley refers to the requirements of section 13(d) as "especially painful" and "exceedingly costly" for large institutional investors.[234] The alternative is to file on Schedule 13G, as allowed by section 13(g) of the Exchange Act, a provision requiring less extensive and frequent reporting. But to be allowed to file the less onerous Schedule 13G, institutional investors must have acquired their securities without the purpose or effect "of changing or influencing the control of the issuer"[235]—an issue

they propose (creating the position of professional outside directors); they contend that the rules' "importance is exaggerated." Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 894 (1990).

[229] 15 U.S.C. §§ 78m(d), 78p(b) (2012).

[230] 17 C.F.R. § 240.13d-101 (2018).

[231] *Id.* § 240.13d-2(a).

[232] 15 U.S.C. § 78m(d)(3) (2012).

[233] *See* CHRISTOPHER G. KARRAS, GEOFFREY WALTER & KEVIN S. BLUME, DECHERT LLP, U.S. COURT CLARIFIES: SHAREHOLDERS ACTING IN CONCERT MAY NOT BE A "GROUP"; CONTRAST WITH ENGLISH LAW "CONCERT PARTIES" APPROACH 2 (Sept. 2011), https://s3.amazonaws.com/documents.lexology.com/4deb00d7-b082-4224-80c6-c1965808c3d4.pdf [https://perma.cc/99Y5-67FD] ("These characterizations of group formation go well beyond the short list of acts specified in the Exchange Act . . . .").

[234] For a detailed explanation, see John D. Morley, *Too Big to Be Activist*, S. CAL. L. REV. (forthcoming 2019) (manuscript at 14, 18), https://papers.ssrn.com/sol3/papers.cfm?abstract_id =3225555.

[235] 17 C.F.R. § 20.13d-1(b)(1)(i).

involving a highly contextual inquiry.[236] The rules are believed to chill concerted action by institutional investors, making them wary to cooperate with their peers and engage with portfolio companies.

To the extent U.S. institutional investors do act collectively, they have stronger incentives to involve third-parties such as proxy advisors than trade groups. As Professor Mark Roe has noted, Section 13(d) and other rules discouraging institutional investor activism are political responses to popular American distrust of accumulations of economic power.[237] This distrust is a "widespread attitude that large institutions and accumulations of centralized economic power are inherently undesirable and should be reduced, even if concentration is productive."[238] Aware of these political forces, and lawmakers' responses to them, institutional investors would seem more likely to act collectively through third parties that provide them with cover from the threat of political reprisal. Unaffiliated actors like proxy advisors give more cover than member organizations formed to act for their members.

The British landscape reflects less suspicion than the U.S. regime about accumulations of economic power. Trade groups formed in an environment with few constraints on concerted action by institutional investors and no rules equivalent to Section 13(d).[239] Even when equivalent provisions to Section 13(d) arrived in the United Kingdom, though imposing onerous requirements, they avoided restricting shareholders from coordinating their activities in overseeing their portfolio companies.

In particular, Rule 5.1 of the Disclosures Rules and Transparency Rules ("DTR") provides a rigorous reporting regime, requiring large shareholders to report to the Financial Conduct Authority ("FCA") once they cross a 3% shareholding level and to frequently update their disclosures as their holdings change.[240] The DTR also has a broad "group" concept; to find that a group exists,

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[236] *See* U.S. SEC. & EXCH. COMM'N, EXCHANGE ACT SECTION 13(D) AND 13(G) AND REGULATION 13D-G OWNERSHIP REPORTING, QUESTIONS AND ANSWERS OF GENERAL APPLICABILITY, Q. 103.11 (July 14, 2016), https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm [https://perma.cc/HFY9-A3QN] (stating test for control should be based on "all the relevant facts and circumstances").

[237] *See* Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 11, 31-53 (1991).

[238] MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 29 (1994).

[239] At the time U.K. trade groups were forming, from the 1930s to the 1960s, institutional investors faced few barriers to coordinating their stewardship efforts. *See* John C. Coffee, Jr., *The SEC and the Institutional Investors: A Half-Time Report*, 15 CARDOZO L. REV. 837, 845 ("[The U.K.] places few, if any, barriers on group activity by institutions . . . ."); CHEFFINS, *supra* note 67, at 45-46 ("[W]hereas US securities law traditionally imposed various restrictions on shareholders minded to work together to pressure managers of a publicly traded company, in the UK communication between institutional investors was largely unregulated.").

[240] FIN. CONDUCT AUTHORITY, DISCLOSURE GUIDEANCE AND TRANSPARENCY SOURCEBOOK

it requires "a lasting common policy towards the management of the issuer."[241] But, in contrast to the U.S. regime, the rule is not intended to limit institutional investors from acting collectively to influence corporate managers of portfolio companies. The rule could have been interpreted to have that effect, which prompted the ISC to submit an inquiry to the Financial Services Authority, the FCA's predecessor. In response, the Financial Services Authority expressed its "strong[] support[]" for institutional investor engagement in portfolio companies and sought to allay institutional shareholders' concerns, explaining that it was "satisfied that there is no fundamental inconsistency" between the rules and shareholder engagement and that it "do[es] not believe that our regulatory requirements prevent collective engagement by institutional shareholders designed to raise legitimate concerns on particular corporate issues, events or matters of governance with the management of investee [portfolio] companies."[242] Other elements of the U.K. regime similarly avoid constraining collective action by institutional investors.[243]

To be sure, certain U.K. institutional investors did fear political reprisal if they exercised too much power over their portfolio companies. During an era of nationalization of certain industries, insurance companies are said to have "feared that high profile interventions could put their affairs on the political agenda and lead to detrimental and perhaps fundamentally crippling reform."[244] Overwhelmingly, however, at least from the 1980s, the British government undertook a fundamentally different role than its U.S. counterpart, reinforcing, guiding, and often encouraging institutional investors' collective engagement efforts. By then, the threat of nationalization of insurance companies had passed.[245]

§ 5.1 (Nov. 2019).

[241] *Id.*

[242] Letter from Sally Dewar, Fin. Servs. Auth., to Keith Skeoch, Chairman, Institutional S'holders Comm. (Aug. 19, 2009), http://www.fsa.gov.uk/pubs/other/shareholder_engagement.pdf [https://perma.cc/D8TL-TUZF].

[243] Under the Companies Act, an issuer can require shareholders to disclose their interests in its shares. Companies Act 2006, c. 46, §§ 793, 824 (Eng.). The relevant provision deems a shareholder to have an interest in another's shares when an agreement exists that imposes "obligations or restrictions on any one or more of the parties to it with respect to their use, retention or disposal of their interests in the shares of the [issuer]." *Id.* § 824(2). These reporting obligations are less demanding than those imposed under Section 13(d) of the Exchange Act in the United States. *See* Black & Coffee, Jr., *supra* note 71, at 2024-25. Separately, U.K. takeover rules require shareholders acting in concert to bid in cash for all shares in a public company once they hold, in aggregate, more than 30% of the company's voting rights, but these rules are unlikely to be triggered by institutional investors planning "one-off interventions [or] even a series of episodic interventions" in portfolio companies. Davies, *supra* note 128, at 369.

[244] CHEFFINS, *supra* note 67, at 380.

[245] *Id*. at 380-81.

Perhaps uniquely among major systems, the British Government, through government-commissioned inquiries and reviews, prodded institutional investors to coordinate their stewardship activities. Government efforts led to the formation of the ISC, the umbrella organization for institutional investor trade groups; the Investor Forum, the institutional investor group tasked with engaging with corporate managers; and the Financial Reporting Council, the public body[246] operating within a framework agreed by government[247] that publishes—with input from institutional investors and corporate managers, among others—the Stewardship Code and Corporate Governance Code. At times, governments have threatened legislation to press institutional investors to take a more active role in overseeing managers.[248] The Bank of England has also exerted pressure on institutional investors to intervene in corporate matters, encouraging them to form representative bodies. Against that threat, and in light of admonitions in government reports,[249] institutional investors had stronger incentives than they would otherwise to coordinate their stewardship efforts—certainly stronger incentives than their U.S. counterparts had to form and act through trade groups.

Finally, the federal mode of the U.S. government may have diminished the appeal of trade groups for institutional investors relative to their appeal in the United Kingdom. Because the United Kingdom operates as a unitary State, U.K. corporate law is not the product of competition among states for corporate charters. In the United States, where states do compete, managers are likely to have stronger sway over rule-making than otherwise because they can credibly threaten to incorporate elsewhere.[250] With stronger managerial sway may come more manager-friendly rules, weaker shareholder rights, and correspondingly weaker incentives for institutional investors to coordinate, including through trade groups.

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[246] The Financial Report Council is a company limited by guarantee. It is funded by both government and levies imposed on various market participants, including auditors, insurance companies, pension funds, and public companies. Its governing board is appointed by the Secretary of State for Business, Energy and Industrial Strategy.

[247] FIN. REPORTING COUNCIL, STRATEGY 2018/21: BUDGET AND LEVIES 2018/19, at 8 (Mar. 2018) ("[We] operat[e] within the framework agreed with Government and independent from those we regulate."). *But see id.* ("Our precise classification as a public body is still under consideration by Government.").

[248] *See supra* note 87 and accompanying text (describing statutory changes allowing the government to pass regulations requiring institutional investors to disclose their voting in portfolio companies).

[249] *See, e.g.*, KAY, *supra* note 50, at 44-45; MYNERS, *supra* note 81, at 89-94; COMM. ON THE FIN. ASPECTS OF CORP. GOVERNANCE, REPORT 49-51 (Dec. 1, 1992), http://www.ecgi.org/codes/documents/cadbury.pdf [https://perma.cc/JF3F-3T8T].

[250] *See* Armour & Skeel, *supra* note 49, at 1766 ("Because they worry that managers will pack the company's bags and move elsewhere if the state is insufficiently attentive to the managers' needs, state lawmakers have powerful incentives to keep corporate managers happy."). *See also supra* note 77 and accompanying text.

E. *Other Issues*

The analysis above identifies four unconventional explanations to account for the greater influence of proxy advisors in the United States than in the United Kingdom. This section considers some factors that may complicate that analysis.

The first concerns legal rules governing institutional investors' voting. While the content of U.S. and U.K. fiduciary rules are similar, there is uncertainty about the requirements of each regime. As to the U.S. regime, many suggest that investment advisers came to rely on and use proxy advisors in order to insulate themselves from liability. According to one commentator, investment advisers

> embraced a view that their reliance on the voting recommendations of proxy voting firms, in accordance with the guidance provided by the [SEC] Staff in *Egan-Jones* and *ISS* and subsequently issued guidance, will insulate their client voting decisions from any conflicts of interest while allowing them to discharge their fiduciary duty of care and loyalty to their clients with respect to proxy voting.[251]

Another commentator observes that investment advisers "determined that they could discharge their duty to vote their proxies and demonstrate that their vote was not a product of a conflict of interest if they voted based on the recommendations of a proxy advisor."[252] The SEC's 2014 guidance would seem to somewhat undermine these interpretations by making clear that blind reliance on proxy advisors does not insulate investment advisers from liability.[253] Nevertheless, these interpretations suggest that many investment advisers believed that relying on proxy advisors would have an insulating effect and acted according to that belief. There is less suggestion under U.K. law that institutional investors either can or believed they can satisfy any fiduciary duties they owe by relying on proxy advisors.

Still, it is difficult to tell how institutional investors' incentives to rely on proxy advisors may have differed between the systems on account of differences in legal rules. SEC interpretations encouraged investment advisers to rely on proxy advisors, but they also weakened investment advisers' fiduciary duties, requiring less active oversight by advisers in managing their portfolio companies, by allowing them more easily to satisfy their fiduciary duties (by relying on proxy advisors). Moreover, through section 13(d) of the Exchange Act and other rules, the U.S. regime differs in having created strong legal barriers to collective action by shareholders, potentially diminishing shareholders' incentives to coordinate their activities, including through proxy advisors. What is clear is that similar proportions of institutional investors in both regimes respond by voting their shares and disclosing their voting

[251] Wolosky, Freedman & Berenblat, *supra* note 37.

[252] U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 5, at 14-15.

[253] *See supra* text accompanying note 43 (describing SEC's 2014 guidance).

records,[254] which at least suggests broad similarity between the respective regimes.

Another issue concerns the increasing proportion of U.K. shares held by foreign investors and whether the resulting geographic dispersion of holdings has weakened both engagement by U.K. institutional investors with portfolio companies and the strength of trade groups, thereby diminishing differences between the United States and United Kingdom discussed above.[255] Historically, U.K. institutional investors were geographically proximate to one another, with their offices located in London or Edinburgh, whereas in the United States institutional investors were geographically dispersed, with their offices spread across the country.[256] The U.K. Office for National Statistics ("ONS") provides data for corporate holdings, showing that since 2012 foreign shareholders have held over half of U.K. public companies' stock.[257] On its face, this data suggests weaker engagement by institutions and their trade groups, given the greater fragmentation of holdings. It also suggests that differences in the geographic dispersion of investors may be less pronounced between the two systems than was clearly once the case.

While U.K. shareholders have become increasingly foreign, the data on the rise of foreign ownership needs to be interpreted with caution. It exaggerates the influence of foreign investors[258] The ONS classifies a shareholder as foreign if it has a parent entity that is foreign-domiciled, without regard to whether the shareholder is itself U.K. domiciled (for example, if it is a U.K. subsidiary of a foreign parent), whether the holdings are managed from within the United Kingdom (for example, if they are managed by a local branch office), or whether the ultimate beneficiaries (the clients) are themselves U.K.-domiciled.[259] In consequence, when a foreign investor acquires a U.K. institutional investor, the holdings of the latter are re-classified as foreign.[260] Similarly, the holdings of major U.S. mutual fund groups—including the Big Three—are classified as foreign, even though they operate in the United Kingdom to some extent through locally-domiciled subsidiaries that are members of U.K. trade groups.[261]

[254] *See supra* notes 108-117 and accompanying text.

[255] *See* Section II.A. As to this issue, see Cheffins, *supra* note 87, at 1017-24 (arguing that fragmentation of share ownership, including increasing holdings of foreign investors, is unlikely to foster greater shareholder involvement in U.K. corporate governance).

[256] *See* Armour & Skeel, Jr., *supra* note 49, at 1791 ("U.S. institutions are still more far-flung than their U.K. counterparts . . . ."). *See also supra* note 174 and accompanying text.

[257] *See* Appendix A, Figs. 3 to 6. I thank Brian Cheffins for challenging and helping to refine the views expressed here on how best to interpret the ONS data.

[258] *See* KAY, *supra* note 50, at 31 ("The figure for foreign 'ownership' is exaggerated since it includes holdings by asset managers whose parent company is US based.").

[259] *See id.*

[260] *Id.* Holdings for the "Rest of the world" category in the Office for National Statistics data include holdings that are "principally run from London." *Id.* at 32.

[261] *See supra* note 51.

The effects of foreign ownership on a shareholder's engagement is probably best understood by considering the domicile of the shareholder's investment adviser. Foreign funds that have U.K. investment advisors based in London might well be as likely as local funds to engage with portfolio companies and act through trade groups.[262] Foreign funds with foreign investment advisors would seem less likely to engage with portfolio companies and act through trade groups, although that will depend on the rules to which those foreign investment advisers are subject.[263] In sum, it is not clear the extent to which the recent growth of foreign ownership in the United Kingdom has altered concerted action by institutional investors, the strength of their trade groups, or differences between the U.S. and U.K. mechanisms of shareholder coordination, although U.K. shareholders are more geographically dispersed than in previous decades, resulting in convergence between the U.K. and U.S. state of affairs. The effects of the internationalization of U.K. shareholders deserve further study.[264]

III. IMPLICATIONS

By comparing the United States and United Kingdom, this Article seeks to improve our understanding of the reasons for proxy advisors' influence in the United States at a time when proxy advisor reform is on the regulatory agenda. Bills propose subjecting proxy advisors to heightened regulation, for example, by requiring them to register as investment advisors or subjecting them to rules

[262] Funds that have U.K. (and perhaps other non-U.S. investors) and that invest in U.K. public companies tend to be advised by U.K. investment advisers. Even if these U.K. investment advisers are subsidiaries of foreign firms (a common arrangement for large U.S. mutual fund groups), and therefore "foreign" for ONS purposes, their U.K. domicile and competition with other funds for U.K. investors may well make them as likely to engage with their U.K. portfolio companies as "true" U.K. investment advisors (those without a foreign parent), especially if they outsource functions to local asset managers.

[263] Funds that have U.S. investors and that invest in U.K. public companies tend to be advised by U.S. investment advisers, which are subject to U.S. fiduciary and other rules regarding voting. Because of their location and the salience of U.K. activities to their overall operations, these funds may be less likely to engage with their U.K. portfolio companies, including via collective action with other institutional investors through trade groups, than U.K. funds, even though U.S. requirements for investment advisers provide incentives for engagement.

[264] Another trend apparent in the United Kingdom worthy of greater attention is the increase in public company shares held by investors, whether U.K. or foreign, other than pension funds, mutual funds, and insurance companies. *See* Appendix A, Figures 4 and 6. Although a significant proportion (some 80% to 90%) of U.K. shareholders are neither individuals nor households and may therefore be regarded as institutional investors, a decreasing proportion of U.K. shareholders are either mutual funds, pensions funds or insurance companies (or their equivalents). For a comparison with the United States, see note 63 and accompanying text. As to a related decrease in holdings by U.K. pension funds and insurance companies, see Cheffins, *supra* note 87, at 1020.

that limit their conflicts of interest.[265] Chairman Jay Clayton lists the reform of proxy advisors among the SEC's immediate rulemaking priorities and identifies "the framework for addressing conflicts of interest at proxy advisory firms" as deserving consideration.[266]

This Article argues that rarely acknowledged factors have power in explaining the influence of proxy advisors in the United States. These factors are the absence of strong trade groups to coordinate institutional investors, uncertainty regarding best practices on a range of governance issues, relatively weak shareholder rights, and governmental skepticism about strong oversight by institutional investors of their portfolio companies. The analysis does not assume or suggest that the U.K. system is optimal in any respect. Indeed, strong support by the British government for institutional investors to engage collectively with their portfolio companies reflected its concern that they were too passive in monitoring their portfolio companies.[267] Comparative analysis nevertheless informs our understanding of proxy advisors' role in the U.S. system.

The analysis here has several implications. First, because it complicates our understanding of why proxy advisors wield the influence they do, the analysis raises questions about the likely effect of proposed reforms, reforms that would subject proxy advisors to greater regulation in order to curtail their influence. Depending on the role that the explanatory factors play, reforms targeting the conventional factors may be inferior to readily available alternatives. For instance, reforms targeting legal requirements to vote, such as the withdrawal of the ISS and Egan-Jones no-action letters,[268] may have limited influence—a plausible expectation if, as the analysis suggests, the outsized influence of proxy advisors in the United States relative to the United Kingdom is largely explained by other factors. It is not enough to form the view, as some have, that proxy advisors wield outsized influence over institutional investors and corporate managers; reform requires a clear understanding of the reasons for that influence, and to date the commentary has generally failed to acknowledge important explanatory factors.

Second, if proxy advisors' influence in the United States needs reining in, the Article's analysis suggests possibilities for curtailing that influence. For

[265] The U.S. House and Senate have introduced bills to regulate proxy advisory firms. *See* Corporate Governance Fairness Act, S. 3614, 115th Cong. (2018) (proposing to amend the Investment Advisers Act of 1940 "to require proxy advisory firms to register as investment advisers under that Act"); Corporate Governance Reform and Transparency Act, H.R. 4015, 115th Cong. (2017) (proposing to amend the Securities Exchange Act of 1934 to require registration of proxy advisors and to subject these firms to "rules to prohibit, or require the management and disclosure of, any conflicts of interest").

[266] Oversight of the U.S. Securities and Exchange Commission: Hearing Before the S. Committee on Banking, Housing, and Urban Affairs, 115th Cong. 9-10 (2018) (statement of Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n).

[267] *See supra* note 126 and accompanying text.

[268] *See supra* note 3 and accompanying text.

example, measures to resolve disagreement over best governance practices would diminish incentives for institutional investors to rely on third-party advisors. Inspired by the British experience with best practice codes, one possibility is for a public body or a working group to prepare, in consultation with institutional investors, corporate managers, and other market participants, guidelines or principles setting out best practices. Of course, differences within the U.S. corporate governance industry may be too great for such an approach to attract support or succeed. There is significant resistance to one-size-fits-all approaches,[269] which best practice guidelines may be seen to impose, especially if industry norms develop that discourage companies to depart from them, as seems to have happened in the United Kingdom.[270] Nevertheless, a statement reflecting common ground among corporate managers and institutional investors would offer important benefits. The U.K. experience shows that best practice codes promulgated by independent bodies, as well as by investor trade groups, prevent proxy advisors from dictating widely adopted governance measures.[271] Such statements or codes might diminish the influence proxy advisors have over discourse on corporate governance issues and mitigate the related concern that they deprive managers of "essential latitude" in running their companies."[272]

The United States could also adopt measures to empower trade groups. The obstacles created by section 13(d) of the Exchange Act are well known; they could be addressed to allow institutional investors greater freedom to coordinate without fear of triggering the regime's disclosure requirements. Less modestly, strengthening shareholder rights might encourage stronger trade groups, which could function in some respects as alternatives to proxy advisors, as in the United Kingdom. Government could create pressures for institutional investors to act through trade groups, as it has in the United Kingdom, such as by facilitating the formation of trade groups designed to engage with portfolio companies on operational or strategic questions. The Investor Forum could serve as a model. These measures might shift influence from proxy advisors to trade groups, a change that should attract less opposition given that trade groups are formal representatives of their members, more accountable to them than proxy advisors, and less susceptible to the conflicts of interest that afflict some proxy advisors.

Third, if proxy advisors are functional substitutes for trade groups in some respects, as this analysis suggests, one might expect proxy advisors' influence to naturally wane in response to conflicts of interest. Some proxy advisors face

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[269] For arguments against a one-size-fits-all approach to governance, see Rose, *supra* note 20, at 907-19.

[270] *See supra* note 195 and accompanying text.

[271] As explained, U.K. trade groups developed voting guidelines that sidelined similar initiatives by major proxy advisors; in fact, proxy advisors ISS and Glass Lewis were left to base their U.K. voting guidelines on those of trade groups. *See supra* notes 154-158 and accompanying text.

[272] *See supra* note 21 and accompanying text.

conflicts of interest by providing services to corporate managers. Proxy advisors' conflicts worry regulators, quite rightly, because they can compromise proxy advisors' capacity to represent institutional investors' interests—and they also distinguish proxy advisors from U.K. trade groups, which do not act at odds with their members' interests in the same way. Of course, proxy advisors use tools to cabin the effects of conflicts, including information barriers or Chinese walls—measures that are standard for mitigating concerns about conflicts and the misuse of nonpublic information within financial conglomerates, even though empirical evidence suggests they lack complete effectiveness in staunching information flows.[273]

To the extent these measures fail to mitigate the adverse effects of advisors' conflicts, one would expect institutional investors to rely less on proxy advisors, seek advisors that avoid conflicts, or rely more on investor trade groups to coordinate their activities. Indeed, some U.S. institutional investors are said to have "migrated away" from using ISS, concerned about its conflicts of interest.[274] Major institutional investors formed the Investment Stewardship Group to produce their own codes that roughly mirror the Corporate Governance Code and Stewardship Code in coverage, diminishing reliance on proxy advisors and perhaps reflecting concern about conflicts.[275]

Reforms designed to ensure that proxy advisors better represent institutional investors' interests may assure that proxy advisors continue to have influence over institutional investors and corporate managers. Falling within this category of reforms are measures that limit the conflicts of interest afflicting proxy advisors or that require them to provide more accurate information to investors. By requiring proxy advisors to better serve investors, reforms may be assuring proxy advisors a central, ongoing role in governance, countering the loss of influence that their conflicts or other deficiencies in their services would otherwise bring.

For those concerned about the influence of proxy advisors in the United States, the irony is that corporate managers' longstanding opposition to shareholder rights may have created conditions that hampered the emergence of strong institutional investor trade groups. On a wide range of issues, boards have refused to give shareholders rights that are taken for granted in other common law jurisdictions. They have adopted measures, such as poison pills and staggered boards, that have no functional counterparts in the United Kingdom. In the name of tailoring individual arrangements for companies, boards generally have resisted broad-based rights for shareholders along the lines of those existing in the United Kingdom, leaving U.S. shareholders, by and large,

[273] As to the use of information barriers in financial conglomerates and evidence on their effectiveness in limiting information flows, see Andrew F. Tuch, *Financial Conglomerates and Information Barriers*, 39 J. CORP. L. 563, 570-92 (2014).

[274] *See* Rose, *supra* note 20, at 923 (citing Dean Starkman, *A Proxy Adviser's Two Sides: Some Question Work of ISS for Companies It Scrutinizes*, WASH. POST, Jan. 23, 2006, at D1).

[275] *See supra* notes 168-170 and accompanying text.

with significantly less influence over the management and affairs of the corporation, even on important corporate matters such as director elections. Other factors also played roles.[276] Had strong insitutional investor trade groups been encouraged or even allowed to form in the United States, proxy advisors would almost certainly not have gained the influence that they now wield.

CONCLUSION

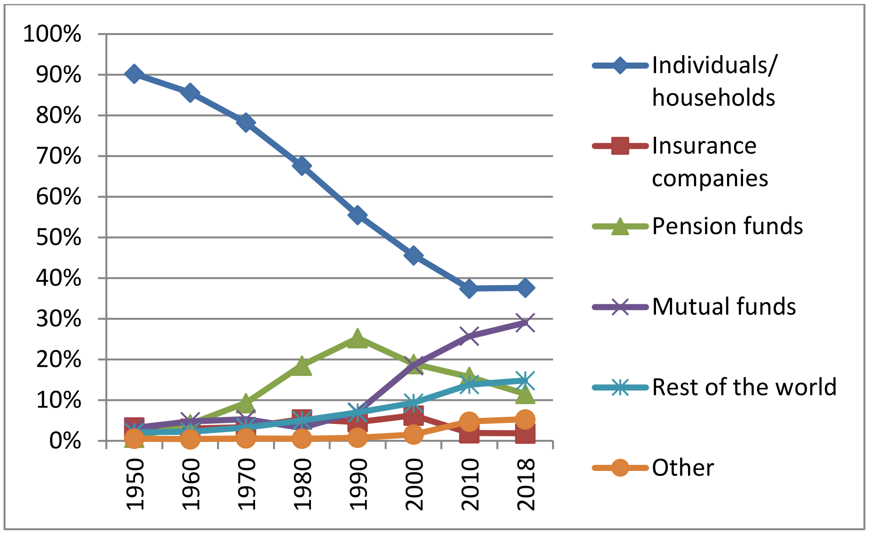
This Article complicates the prevailing understanding of why proxy advisors exert the influence they do over American institutional investors and corporate managers. Commentators have advanced fairly standard explanations for proxy advisors' influence. By comparing the U.S. and U.K. systems, this Article identifies other, unconventional factors with important explanatory power: institutional investors have lacked strong trade groups for coordinating their stewardship efforts, which has allowed space for proxy advisors; U.S. rules have left open a range of governance questions, increasing the need for services provided by proxy advisors; institutional investors have had weak governance rights as shareholders, conditions that have made concerted action by investors more likely to occur through proxy advisors than through trade groups; and the State has shown itself both wary of strong institutional investor oversight of corporate managers and willing to respond to popular sentiment against powerful shareholders, making institutional investors less likely to act collectively and to the extent they do act collectively, more likely to act through proxy advisors than through other channels. Without considering these factors, one cannot convincingly explain why proxy advisors wield as much influence as they do in the United States.

By suggesting new factors to explain proxy advisors' influence, the Article invites greater scholarly attention to the explanatory power of features unique to the U.S. corporate governance landscape. Comparative study may be more fruitful than studying the United States in isolation because the comparative inquiry helps control for factors in common with other systems and points to unrecognized legal, institutional, and other features that may be taken for granted or obscured in a single-system study. The Article also casts doubt on the merits of existing ideas for reform and generates fresh options. It illuminates in the United States how proxy advisors perform a coordinating function that institutional investor trade groups perform elsewhere, what legal and other factors impede concerted action by institutional investors, how corporate managers may have unwittingly helped strengthen proxy advisors by opposing stronger shareholder rights, and how reforms intended to weaken proxy advisors may strengthen their ability to coordinate institutions' activities and ultimately assure their continued influence.

[276] *See, e.g., supra* notes 174-180 and accompanying text. As to the role of the state, see Section II.D.

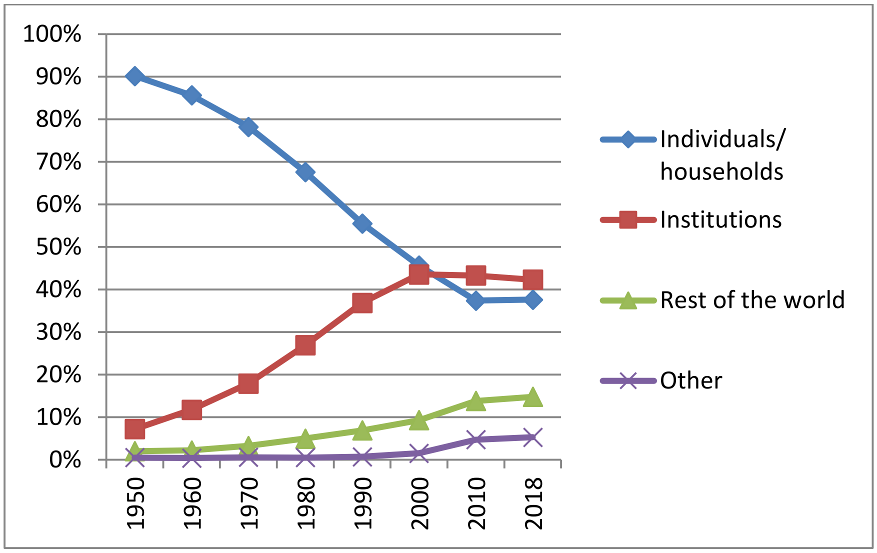
Appendix A

Figure 1. Share ownership patterns in the United States, 1950-2018.[277]



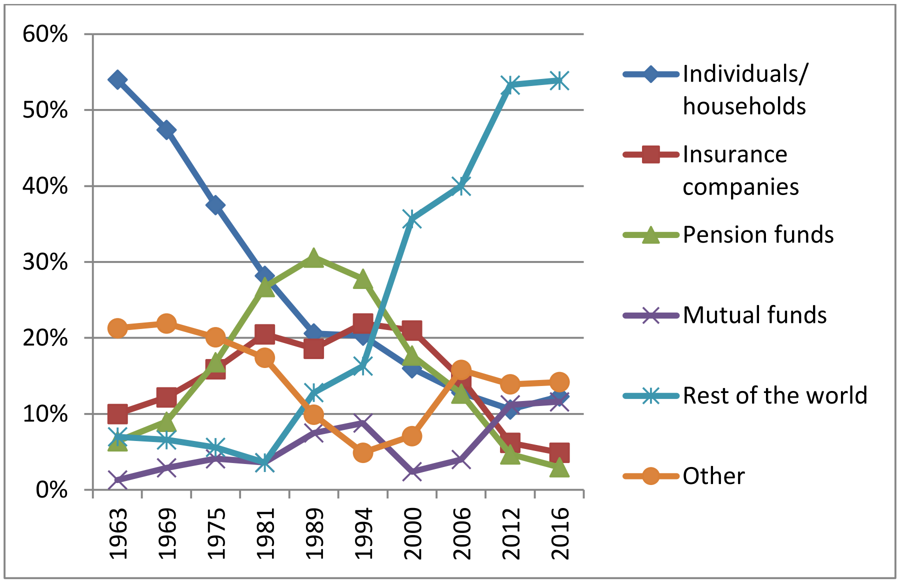
277 BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE U.S.: ANNUAL FLOW AND OUTSTANDINGS, 1945-1954, at 82 tbl. L.213; BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE U.S.: ANNUAL FLOW AND OUTSTANDINGS, 1955-1964, at 82 tbl. L.213; BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE U.S.: ANNUAL FLOW AND OUTSTANDINGS, 1965-1974, at 82 tbl. L.213; BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE U.S.: ANNUAL FLOW AND OUTSTANDINGS, 1975-1984, at 82 tbl. L.213; BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE U.S.: ANNUAL FLOW AND OUTSTANDINGS, 1985-1994, at 82 tbl. L.213; BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS IN THE U.S.: ANNUAL FLOW AND OUTSTANDINGS, 1995-2005, at 82 tbl. L.213 (2006); BOARD OF GOVERNORS OF THE FED. RESERVE SYS., HISTORICAL ANNUALS, 2005-2015, at 123 tbl. L.223 (2016); BD. OF GOVERNORS, FLOW OF FUNDS 2018, *supra* note 64, at 122 tbl. L.223. Although the Federal Reserve's Flow of Funds data is routinely used to illustrate changes in U.S. shareholdings over time, that data measures "corporate equity," which encompasses both public company stock and stock in closely held companies. *See* James M. Poterba & Andrew A. Samwick, *Stock Ownership Patterns, Stock Market Fluctuations, and Consumption*, BROOKINGS PAPERS ON ECON. ACTIVITY, Oct. 1995, at 295, 312. The data for the category "Individuals/households" includes nonprofit institutions, which typically account for around 15% of that category. *Id*. at 312-14.

Figure 2. Share ownership patterns in the United States, 1950-2018.[278]



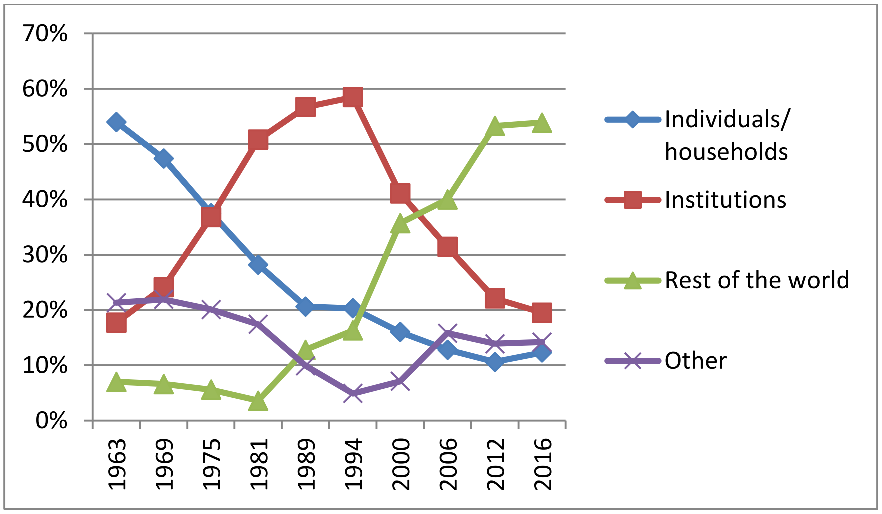
[278] *See supra* note 277. Figure 2 uses identical data to Figure 1 except that the "Institutions" category aggregates data in Figure 1 for Mutual funds, Pension funds, and Insurance companies.

Figure 3. Share ownership patterns in the United Kingdom, 1963-2016.[279]



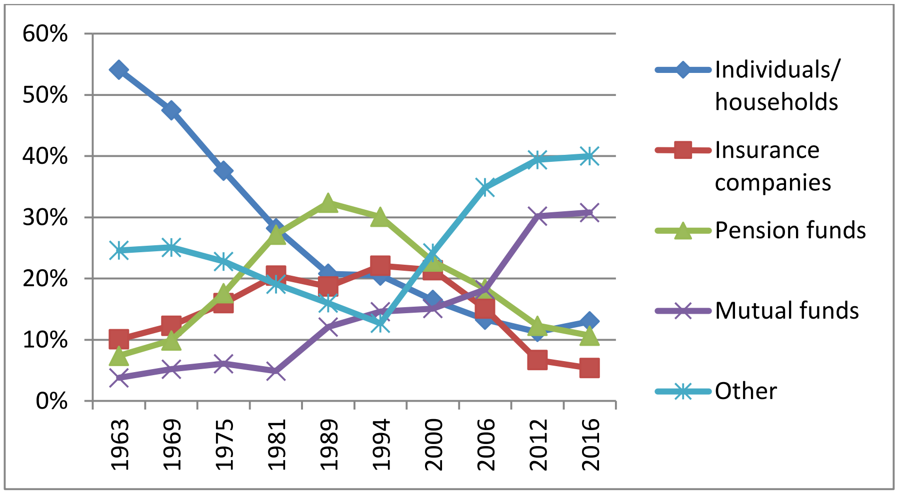
[279] Office for Nat'l Statistics, *supra* note 65, at figs.3-8. The "Rest of the world" category needs to be interpreted with caution. *See supra* notes 256-268 and accompanying text. That category includes foreign investors, among them mutual funds, pension funds, insurance companies, banks, private non-financial companies and public sector entities (including sovereign wealth funds). *Id*. at tbl 5. The "Other" category includes share ownership by U.K. investors, among them charities, hedge funds, private non-financial corporations, public sector entities (such as local governments and public corporations), banks and other financial institutions, and, from 1963 to 1981, investment trusts. *Id*. tbl. 12.

Figure 4. Share ownership patterns in the United Kingdom, 1963-2016 (based on Figure 3 and aggregating holdings by institutional investors).[280]



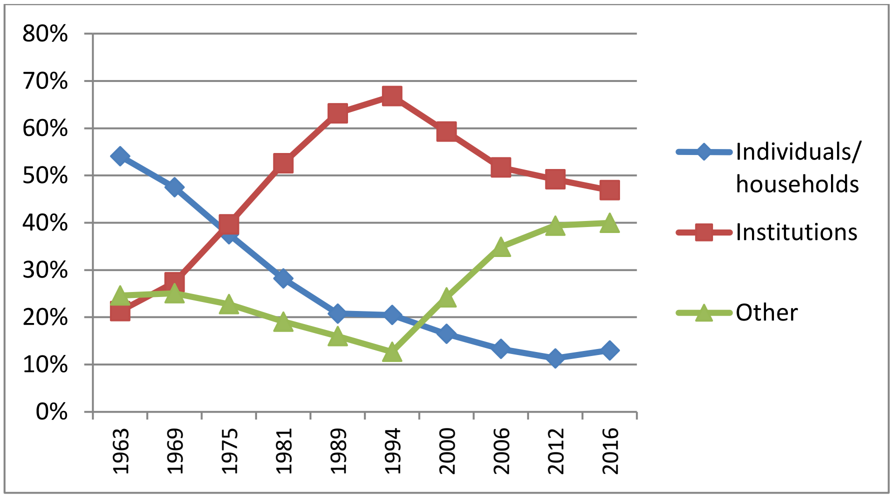
[280] *Id.* Figure 4 is identical to Figure 3 except that the "Institutions" category aggregates data in Figure 3 for Mutual funds, Pension funds, and Insurance companies. The "Rest of the world" category needs to be interpreted with caution. *See supra* notes 256-268 and accompanying text.

Figure 5. Share ownership patterns in the United Kingdom, 1963-2016 (based on Figure 3 and allocating "Rest of the world" data to other categories).[281]



[281] *Id.* Figure 5 is identical to Figure 3 except that the "Rest of the world" data in Figure 3 is allocated among other categories of shareholder (Individuals/households, Insurance companies, Pension funds, and Mutual funds) based on data available in OFFICE FOR NAT'L STATISTICS, *supra* note 65, at tbl.5 that breaks down "Rest of the world" data. That breakdown is available for 2016 only, but is applied here across all periods, potentially distorting results. "Rest of the world" data in Figure 3 that is not allocated among such other categories of shareholder is included in the "Other" category in Figure 5. The "Other" category therefore includes holdings by foreign investors, among them banks, private non-financial companies, and public sector entities (such as sovereign wealth funds). *See id*. at tbl 5. The "Other" category also includes holdings by U.K. investors, among them charities, hedge funds, private non-financial corporations, public sector entities (such as local governments and public corporations), banks and other financial institutions, and, from 1963 to 1981, investment trusts. *Id*. at tbl. 12.

Figure 6. Share ownership patterns in the United Kingdom, 1963-2016 (based on Figure 5 and aggregating holdings by institutional investors).[282]



[282] *Id.* Figure 6 is identical to Figure 5 except that the "Institutions" category aggregates data in Figure 5 for Mutual funds, Pension funds, and Insurance companies.