Policy Report

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Restoring *Balance*

Transparency, Accountability, and Market-Based Reforms to Curb Proxy Advisor and Activist Overreach

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EXECUTIVE SUMMARY

Proxy advisors and activists, far from promoting efficient corporate governance, often distort corporate behavior in ways that harm long-term investment, competitiveness, and economic growth.

The more fundamental problem, however, is not any particular ideological agenda advanced through these channels, but the structural opacity and accountability failures of the proxy advisory system itself. These failures include the conflicts of interest baked into the advisory model, the leverage that system provides to outside actors seeking to influence boards, and the absence of fiduciary accountability running through the entire chain from beneficial owner to governance outcome.

Section 1 introduces and defines three key actors influencing U.S. corporate governance: proxy advisors, activist investors, and institutional investors; and explores recent trends towards short-termism, market distortions, and less long-term investment. Section 2 outlines funding sources and incentives for activists. Section 3 explores the role, methodology, and influence of proxy advisors. Section 4 examines the intersection of proxy advisors and activists to understand how activists leverage proxy advisors, and the shared incentives and overlapping players. Section 5 describes the many harms to the U.S. economy including short-termism and underinvestment as firms may choose to stay private. Other harms include an over-concentration in the market and weakened competition, as well as the misallocation of capital. There are also increased costs of compliance,

reporting, and governance in the form of proxy fights, legal fees, and services. This erosion of accountability and transparency then leads to broader social and economic harms such as negative impacts to employees, innovation, and long-term industry stability. The system can also be weaponized as an anti-competitive instrument, enabling dominant incumbents to use proxy campaigns and institutional investor influence to suppress disruptive rivals they could not defeat through ordinary market competition. More gravely, this same opacity creates a national security vulnerability, offering foreign adversaries a low-visibility channel through which to influence the governance of U.S. companies in critical industries. Section 6 presents empirical evidence and key gaps in methodology, data, and topics. Section 7 summarizes some common arguments in favor of proxy advisors and activists and refutes them. The concluding Section 8 offers policy recommendations organized around three distinct actor audiences: what the SEC and executive branch can pursue administratively; what Congress can enact legislatively, such as registration requirements and a private right of action against proxy advisors, as well as reforms restructuring how passive index funds exercise their voting power so that it reflects the preferences of the beneficial owners who bear the economic interest; and what non-federal actors, including state attorneys general, institutional investors, and market participants, can do independently.

Section 1: Introduction

To set the stage for the need to restore balance in corporate governance, it is important to define the three key actors: proxy advisors, activist investors, and institutional investors.

Proxy advisory firms **(hereinafter proxy advisors) are research-based firms that issue voting recommendations to institutional investors on matters requiring shareholder approval.** These recommendations cover key corporate governance practices such as director elections, executive compensation, mergers and acquisitions, and shareholder proposals. The proxy advisory industry is a duopoly with two majority foreign-owned firms, Glass Lewis and Institutional Shareholder Services (ISS), controlling nearly the entire market (Glassman & Peirce, 2014). ISS and Glass Lewis control an estimated 97% (U.S. House Committee on Financial Services, 2025) or 98% (Spatt, 2021) of the market, with 61% to ISS and 37% to Glass Lewis (Spatt, 2021).

Activist investors **are individuals or organizations, most commonly hedge funds, and less commonly private equity firms, who purchase a significant minority stake in a firm to influence a company's strategic direction, governance structure, or capital allocation.** Activist investors' tactics include launching public campaigns, pushing for board seats, demanding operational changes, or pressuring companies to adopt specific environmental, social, or financial strategies.

Institutional Investors **are pension funds, mutual funds, insurance companies, university endowments, sovereign wealth funds, and commercial banks that manage large pools of capital on behalf of clients, customers, members, shareholders, or other beneficiaries.** As a result, institutional investors hold significant voting power in public companies and often rely on proxy advisors to guide their votes. Less common is the phenomenon of institutional investors turning to activism after years of owning a disappointing investment; however, these investors are less likely to use publicly observable confrontational tactics. As institutional investors are expected to be more knowledgeable and better able to protect themselves than retail investors (i.e., non-professional individuals who buy and sell securities), there are fewer protective regulations. Institutional investors account for a significant percent of all stock trading activity

(FINRA, 2026), with estimates over 90%. The largest institutional investor is BlackRock which holds over $10 trillion in assets under management. Other large institutional investors include Vanguard Group, Fidelity Investments, State Street Global Advisors, J.P. Morgan, and Goldman Sachs. Institutional investors earn fees and commissions from their clients. For example, a hedge fund may charge a certain percentage of the dollar value of a client's assets under management. Hedge funds may also charge flat fees for holding an account or for making trades or withdrawals.

Why this Matters

The proxy advisory system matters not because it occasionally produces bad governance outcomes, but because it has become the primary mechanism through which outside actors (e.g., activist hedge funds, ideological advocacy organizations, or foreign-affiliated interests) can exert decisive influence over American corporate boards without acquiring control rights, assuming accountability, or disclosing their ultimate interests.

Proxy advisors, institutional investors, and activist investors have gained significant influence over corporate decision-making in the last few decades. In a classic archetype of corporate governance, informed shareholders would vote their own shares. For many decades in corporate governance research, teaching, and policy making, the key "agency problem" was articulated as a "principal-agent conflict" whereby the goal was for the shareholders (principals) to ensure that the agents (firm managers) acted in shareholders' best interests. This framework has changed substantially due to growing demands for diversification of assets, such that now most investors indirectly hold their equity assets through a variety of intermediaries. For example, in the U.S., institutional investors owned less than 20% of publicly traded equities in the 1960s (Glassman & Peirce, 2014), but this had ballooned to 73% by 2017 (Lewellen & Lewellen, 2022).

At present, over 100 million Americans own shares in mutual funds, typically through employer-sponsored retirement plans (i.e., 401(k)s) and are thus twice removed from the managers who run the companies in which they invest—a problem known as the "double dilution of ownership" (Ryall & Terjesen, 2023). In this intermediated equity ownership model, although the individual investor owns the assets (and their cashflow rights), the asset manager exercises the control rights (voting power). This is exacerbated by other regulations, such as Dodd-Frank, which mandate voting on executive compensation (i.e., "say-on-pay"). Institutional investors are thus legally required to vote, either independently or, as found consistently in research, by following proxy advisors' voting recommendations. Following required shareholder say-on-pay voting mandated by Dodd-Frank in 2011, one study found that proxy advisory firm recommendations substantially impacted say-on-pay voting outcomes, and that a significant number of firms changed their compensation programs just prior to formal shareholder votes in order to be consistent with the features known to be favored by proxy advisory firms (Larcker, McCall & Ormazabal, 2015). Copland, Larcker, and Tayan (2018: 12-13) report that "95% of institutional investors vote in favor of a company's say-on-pay proposal when ISS recommends a favorable vote, while only 68% vote in favor when ISS is opposed. Similarly, when ISS recommends a favorable vote, equity plan proposals receive 17% more votes in favor and uncontested director elections receive 18% more votes in favor. Proxy contests receive 73% more votes in favor when ISS supports the measure. Glass Lewis also influences voting outcomes: its recommendations of favorable votes are associated with 16%, 12%, and 64% increases in institutional investor support for say on pay, equity plan, and proxy contest ballot measures."

Another growing trend is activists who seek to influence corporate activities. The next section outlines their funding sources and incentives.

The deeper and more fundamental concern is not any single ideological agenda carried through these channels, but the structural opacity and unaccountability of the proxy advisory system itself. The system is characterized by pervasive conflicts of interest: ISS simultaneously sells consulting services to the companies whose governance it rates, creating a pay-to-play dynamic that compromises the independence of its recommendations. Glass Lewis is majority-owned by Peloton Capital Management, a Canadian private equity firm, together with the financier Stephen Smith, who acquired Glass Lewis in 2021 from the Ontario Teachers' Pension Plan and the Alberta Investment Management Corporation. Its foreign ownership, like that of ISS, contributes to the accountability and national-security concerns discussed below. It should be noted that Glass Lewis provides voting recommendations that institutional investors may adopt or reject; Glass Lewis does not itself cast votes on behalf of shareholders. ISS is currently a registered investment advisor (RIA) under the Investment Advisers Act, and Glass Lewis indicated in November 2025 that it was open to exploring registration as an RIA, though it has not formally committed to doing so. As RIAs, these firms are subject to certain conduct standards and a duty of care running to their institutional investor clients. However, neither firm owes fiduciary duties to the pension beneficiaries, retail investors, or other ultimate principals whose savings are affected by governance decisions shaped by their recommendations. The accountability gap this paper identifies is therefore the absence of fiduciary duties running to beneficial owners, as distinct from the firms' paying institutional investor clients.

A significant recent development reinforces the urgency of this accountability gap. On April 15, 2026, the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) issued Technical Release 26-01, the first guidance of its kind declaring that proxy advisory firms "generally" meet the test for being investment advice fiduciaries under ERISA's long-standing five-part test and qualify as functional fiduciaries under the Employee Retirement Income Security Act of 1974 (U.S. Department of Labor, EBSA Technical Release 26-01, April 15, 2026). Critically, the guidance extends beyond proxy advisors themselves: at the President's directive, EBSA also examined when the actions of large asset managers, sovereign wealth funds, and other actors who manage or advise on the exercise of shareholder rights held by ERISA-covered plans render those parties investment advice fiduciaries as well. While the Technical Release is expressly grounded in the ERISA context, it represents a significant legal development for the broader fiduciary reform agenda. If fiduciary obligation is now recognized for actors advising on the proxy votes of pension plan assets, the principled case for extending equivalent duties to proxy advisors' recommendations affecting the broader universe of retail index fund investors and non-ERISA retirement savers is substantially strengthened. The Technical Release should be treated as a floor, not a ceiling, for the fiduciary reforms proposed in Section 8 of this paper.

And because the methodology underlying proxy advisors' recommendations is opaque and largely proprietary, rated companies, shareholders, and the public cannot independently evaluate whether those recommendations serve any consistent standard of good governance. This opacity is not incidental; it is the mechanism through which outside actors (e.g., ideological advocacy organizations, activist hedge funds, and foreign-affiliated interests) gain leverage over American corporate boards. The harms are all downstream consequences of this structural problem, and result in harms such as ESG overreach, short-termism, erosion of board authority, and national security risks. Any serious reform must address the opacity and conflict of interest at the root of the system, not merely its most visible symptoms.

Section 2: Funding Sources & Incentives for Activists

Activist investors are individuals or organizations (e.g., hedge funds and private equity firms) purchasing a significant minority stake in a firm to influence a company to make changes. Other activists do not own significant shares in firms, often operating as 501(c)(3) non-profits to push social and ideological agendas. Activism methods include proxy battles, publicity campaigns, shareholder resolutions, litigation, or negotiations with management.

Funding Sources and Transparency

The activist investor base has diversified to include large institutional investors, family offices, and long-only asset managers. There is a general lack of transparency around the capital flowing into the different categories of activists who sometimes coordinate efforts.

Activist investors require substantial capital to purchase a significant minority share in a publicly traded company. This funding typically comes from large institutional investors (e.g., pension funds, endowments, and sovereign wealth funds), wealthy individuals, and family offices. Many activist funds rely on hedge fund structures or special-purpose investment vehicles to pool capital. However, not all funding is fully transparent. Some activist funds keep small stakes, and quietly coordinate with other investors, or operate through intermediaries, thus making it difficult for companies and the public to determine who is backing campaigns. Any single investor who acquires more than 5% of a company's voting shares and intends to influence company actions must file Schedule 13D to the SEC within ten days, disclosing the reasons for acquiring a stake and plans for mergers and acquisitions, asset disposals, capitalization or dividends, or other policies. The Schedule 13D filing is an opportunity for activist investors to publicize their case against the target company. Investors who do not intend to be activists instead file a Schedule 13G.

For advocacy non-profits, the required tax documents provide some insight. The most prolific activist non-profit is California-based As You Sow which filed 210 exempt solicitations and 453 14a-8 proposals with Russell 3000 firms from 2018 to 2025. Advocacy-oriented As You Sow focuses on "stakeholder capitalism" (i.e., non-shareholder interests) in the form of environmental, social, and governance (ESG) change, and is heavily funded by George Soros' Foundation to Promote Open Society and the Open Society Foundation, as well as Energy Foundation, Tides Foundation, and Ford Foundation.

Most activist hedge funds—unlike traditional asset managers—aren't required to disclose funding sources in detail, although large institutional backing is typical. Activist hedge funds are typically structured like traditional hedge funds, usually charging a management fee and a performance fee. Activist hedge funds' longer investment horizon typically aligns with the time required to launch and see activist campaigns to completion. Activist hedge fund investors include high-net-worth individuals, pension funds, endowments, and increasingly, sovereign wealth funds, and often maintain concentrated positions in target companies to maximize influence.

Financial vs. Social/Ideological Incentives

Historically, activist investors have sought to maximize shareholder value through operational, financial, and governance changes, such as cost-cutting, restructuring, or promoting new management. The fee and compensation structures for fund managers provide strong personal incentives for identifying undervalued companies and engineering changes to boost returns.

During the last two decades, activist investors' financial goals have been increasingly accompanied (or replaced) by social and ideological goals that focus on ESG outcomes (Terjesen & Ryall, 2025). Activist investors' goals can be reflected in proxy contest filings. A proxy contest (also known as a "proxy fight") is a campaign by shareholders, typically activists or acquirers, seeking to persuade other investors to vote to replace a company's board of directors or approve a major change. A proxy functions like a corporate election, challenging existing management strategy, often following poor performance or during a hostile takeover attempt. Proxy fights about ESG issues surged from 2021 onwards, with approximately 322 ESG-focused shareholder proposals (not full proxy contests) in 2023, particularly addressing climate change and workforce diversity. Note that shareholder proposals placed on company ballots differ from proxy contests, which involve competing slates of director nominees.

Activist investors' incentives are often aligned to proxy advisor policy, especially for controversial ESG mandates. For example, Glass Lewis (2024) 2024 Public Pension Policy Guidelines (a pension-fund-specific voting framework, distinct from Glass Lewis's standard benchmark policy) states: "if less than 30% of the board is female, the Public Pension Policy will vote against the entire incumbent male nominating committee; however, where local market standards dictate a higher level of expected gender diversity, the Public Pension Policy will follow the local market requirement." Glass Lewis' extremist global climate change agenda is also evident in the guidelines: "For companies included in the Climate Action 100+ focus list and those that operate in industries where the Sustainability Accounting Standards Board (SASB) has determined that greenhouse gas ("GHG") emissions represent a financially material risk, the Public Pension Policy will vote against the chair of the board in instances where a company has not adopted a net zero emissions target or ambition."

Section 3: Proxy Advisors: Role, Methodology, Transparency, and Influence

The U.S. proxy advisory industry is a duopoly dominated by two majority foreign-owned firms: Institutional Shareholder Services (ISS) and Glass Lewis. Although there are several other firms with minuscule market shares such as Egan-Jones Proxy Service, this report focuses on ISS and Glass Lewis because of their complete dominance in the U.S. market. ISS advises on 40,000 shareholder meetings in 117 countries, and Glass Lewis advises on 20,000 shareholder meetings in 100 countries.

Role

Proxy advisors play a central role in the corporate governance ecosystem by providing research, data intelligence, and voting recommendations to institutional investors who manage large pools of capital. Proxy advisors' main function is to guide investors on complex corporate decisions, such as board director elections, executive pay packages, mergers and acquisitions, and shareholder proposals. By synthesizing information from a variety of sources (e.g., proxy statements, financial disclosures, and governance policies), proxy advisors are purported to help investors vote efficiently, especially when managing portfolios with hundreds of companies. Proxy advisors issue guidance on thousands of companies simultaneously, such that a single recommendation can sway millions of votes across multiple companies.

Methodology and Transparency

Proxy advisors examine company financials, governance structures, board composition, executive pay practices, ESG factors, and other strategic issues.

After both quantitative and qualitative analysis, advisors issue voting recommendations of "for," "against," or "abstain." Proxy advisors' methodology is opaque as there are neither requirements to publicly disclose how voting guidelines are developed nor to submit evidence that recommendations are warranted. ISS does maintain a formal annual policy survey process through which its benchmark voting guidelines are updated and stakeholder input is solicited before each proxy season. Taking opaque proprietary methodologies and limited disclosure together, investors and companies are following guidance without full visibility into underlying assumptions or potential conflicts of interest.

A large share of proxy advisory work is seasonal from April to June. RiskMetrics' ISS Voting Analytics database from 2003-2018 shows on average 303 proposals voted each day during the five-week proxy season— a ten-fold increase over the average of 28 proposals voted per day outside proxy season. During the busy proxy season, proposals are 26.1% less likely to get a negative ISS recommendation, even after controlling for a variety of factors, and furthermore that ISS recommendations during proxy season are of lower quality (Calluzzo & Kedia, 2025). These recommendations may be driven by a variety of means to accommodate the busy period including hiring seasonal workers, outsourcing, or redistributing work.

Recent research describes how profit-maximizing proxy advisors benefit from "producing informative, unbiased reports, but only partially informative recommendations, biased against the a priori likely alternative" as these "recommendations induce close votes, increasing controversy and thereby the relevance and value of proxy advice" (Malenko, Malenko, & Spatt, 2025: 2303). Thus, proxy advisors maximize profits by selling detailed research reports to subscribers and by issuing subscriber-only voting recommendations. This bias increases controversy over votes, heightening the chances of close votes, which in turn encourages more shareholders to pay for detailed research reports. At the same time, the model holds that proxy advisors produce unbiased reports for paying subscribers, even as the recommendations drawn from them are only partially informative and strategically biased.

Because many institutional investors automatically follow proxy advisor recommendations, even minor analytical errors can have major consequences. This has led to calls for reforms to enhance transparency, ensure methodological rigor, and reduce potential conflicts of interest in the proxy advisory industry.

Influence: Robo-voting and AI-driven internal alternatives to proxy advisors

As institutional investors typically oversee very large portfolios and must vote on hundreds of proposals across many different companies in a variety of industries, they rely heavily on proxy advisors. The "robo-voting" phenomenon describes when an investment fund mechanically votes in a corporate election according to proxy advisor advice. A study of 65 million votes cast by 14,582 mutual funds from 2008-2021 finds that robo-voting increased substantially since 2008, and reached a level of about 33% in 2021, with 22% using ISS and 4% using Glass Lewis (Matsusaka & Shu, 2024). Newer, smaller mutual funds are more likely to robo-vote over this same time period (Shu, 2024). Of all 114 robo-voting institutional investors in 2020, 86% use ISS and 14% use Glass Lewis (Rose, 2021).

A new trend is institutional investors leveraging Artificial Intelligence (AI) technology to develop in-house custom solutions, an early sign of the future decline of proxy advisors. In what is believed to be the first time that an institutional investor has not used ISS or Glass Lewis in its proxy voting process, J.P. Morgan Asset Management announced its own AI-powered platform, Proxy IQ, to help decide proxy votes for its

$7 trillion in client assets (Pitcher, 2026). Proxy IQ will analyze data from over 3,000 annual company meetings, provide recommendations to portfolio managers, and manage votes. AI tools are also being developed by researchers. Lee and Souther's (2025) AI model produces voting recommendations that match ISS in 79% of proposals and better predict shareholder support than ISS recommendations alone, finding that disagreements between AI and ISS are more likely when firms disclose hiring a third-party governance consultant.

Section 4: Intersection of Proxy Advisors and Activists

Proxy advisors and activist investors are deeply intertwined in modern corporate governance.

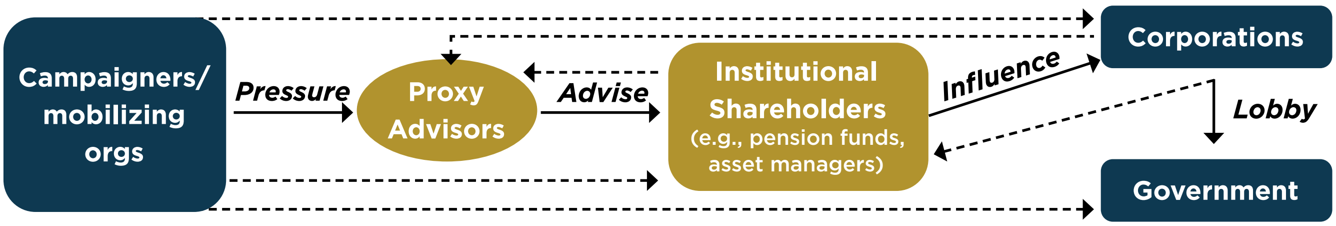
Activists Leverage Proxy Advisors

Activist investors often use proxy advisors' recommendations to gain credibility for their campaigns to change management or board structures. Because institutional investors often follow proxy advisor recommendations, activist campaigns that align with advisor priorities can increase their likelihood of success. For example, activist hedge funds frequently highlight governance, executive compensation, or ESG issues in a way that anticipates the metrics or concerns emphasized by ISS or Glass Lewis. By framing proposals to match these guidelines, activists can generate broader support from pivotal investors, effectively turning proxy advisors into indirect allies in their campaigns. Proxy advisors are central to these campaigns, with Elbra, O'Brien, and Boersma (2025: 1063) concluding that "proxy advisors should be viewed as political actors with significant influence over the outcome of social movement campaigns," as shown in the Figure 1 diagram of norm diffusion.

Shared Incentives and Overlapping Players

The incentives of activists and proxy advisors often overlap, particularly around improving governance and aligning management actions with shareholder interests. While proxy advisors aim to provide research-based guidance that reflects investor preferences, activists are motivated by financial, political, and reputational goals. Both parties benefit from campaigns that result in leadership changes, improved board oversight, or enhanced shareholder value. This shared interest creates a symbiotic relationship: activists use the credibility of proxy advisor support to pressure boards, while advisors maintain relevance by influencing major corporate decisions that attract investor attention. Meanwhile, institutional investors rely on this interplay to make informed decisions.

FIGURE 1: NORM DIFFUSION PROCESS



Source: Elbra, O'Brien, & Boersma (2025)

Case Studies

Several real-world examples illustrate the intersection of activists and proxy advisors. In a 2021 ExxonMobil proxy contest criticizing the company for failing to prepare for a renewable energy transition, the small San Francisco-based hedge fund Engine No. 1 successfully elected three directors to Exxon's 12-member board despite only holding a minor stake. The campaign explicitly designed messaging around governance and sustainability metrics favored by proxy advisors, and succeeded largely because major institutional investors, including the "Big Three" (i.e., BlackRock, Vanguard, and State Street Global Advisors), followed the proxy advisors' favorable recommendations. Engine No. 1 pitched to Wall Street that ExxonMobil stock was underperforming relative to its peers and that the company continued to invest in growing production even though "fossil fuel demand may decline in decades to come", which was a reference to Engine No. 1's belief in an imminent transition to wind and solar energy. The company also canvassed activist groups such as Climate Action 100+ which described the vote as a "day of reckoning (Domonoske, 2021)" and the Sierra Club, which signaled the vote as a message that the era of fossil fuels "is over" (Sierra Club, 2021). The case demonstrates how a well-organized activist can leverage proxy advisor influence to achieve significant corporate change.

Another example is Illumina, a San Diego based biotechnology company that acquired cancer diagnostics company Grail for $8 billion in August 2021, despite pending antitrust reviews by the U.S. Federal Trade Commission (FTC) and European Union. Both regulators ultimately ordered Illumina to unwind the deal, resulting in a $50 billion loss in stock value. With less than 1.5% stake, activist investor Carl Icahn launched a campaign in 2023 to nominate three directors and hold the board accountable. Although both ISS and Glass Lewis recommended against incumbent directors, their recommendations varied with Glass Lewis recommending the replacement of the CEO and the Chair, whereas ISS recommended only replacing the Chair. With both proxy advisors recommending against the Chair, this ultimately led to one of Icahn's nominees to replacing the Chair. Notably, the CEO resigned just weeks after the vote.

Section 5: Economic Harms to the U.S. Economy

The constellation of proxy advisors and activist investors can cause considerable harm to the U.S. economy through short-termism and underinvestment, market concentration, weakened competition, increased costs of compliance, erosion of accountability and transparency, social and broader economic harms, anti-competitive weaponization of the proxy system, and national security implications.

Short-Termism, Underinvestment, and Misallocation of Capital

Short-termism describes the tendency to prioritize near-term financial results, such as quarterly earnings, short-run stock price, or immediate cash returns to shareholders, at the expense of longer-term investments, strategies, and value creation. Corporate managers and investors may feel pressured to make decisions based on these shorter time periods. For corporate managers, activist pressure may lead to a shift away from long-horizon projects. For investors, short-termism takes the form of pressuring managers to take actions that generate near-term returns (special dividends, buybacks, asset sales, cost cuts) regardless of whether those actions serve the company's long-run interests.

Public equity markets are supposed to allocate capital efficiently, channeling investment to the

highest-value uses, and in the process disciplining underperforming management and enabling productive firms to grow. When public markets malfunction, another harm is underinvestment. As proxy advisors and activist investors only operate in public markets, private firms may choose to stay private to avoid this market, and instead rely on private equity and venture capital. While this may benefit management in the short run, private firms can face capital constraints that can slow growth, innovation, and productivity. Since the mid-1990s, the number of U.S. public companies has fallen by about half from about 8,000 to around 4,000 (Doidge, Karolyi, Shen & Stulz, 2025).

Activist campaigns that are successful in forcing share buybacks, special dividends, or asset sales, then redirect capital from internal investment to shareholder distribution. While defenders might argue that this is efficient at an individual firm level as this is returning capital that management might waste, at the aggregate level, activist pressure that is biased toward distribution over investment, reduces productive capital formation across the economy. This is particularly compounded by the composition of activist targets which are typically cash-rich firms with stable free cash flows in mature or moderately competitive industries.

Increased Costs of Compliance, Reporting, and Governance

Public companies face substantial costs related to compliance, reporting, and governance, particularly related to ever-growing investor relations, consultant, and legal expenses.

The expanding governance expectations of proxy advisors and institutional investors have led to investor relations becoming a far more substantive and costly function. Companies must now maintain ongoing dialogue with their largest institutional shareholders on governance matters throughout the year, not just in the short proxy season. This requires dedicated governance staff, typically led by the General Counsel or Company Secretary, with support from investor relations, and with governance expertise, external governance advisors, and senior management time. This office must also handle proxy advisor expectations around voluntary disclosure in the form of sustainability reporting, human capital metrics, executive pay ratio disclosure, board diversity statistics, and climate risk disclosure.

There are also significant costs of hiring consultants and law firms to satisfy proxy advisor firms. Firms must retain compensation consultants to structure programs that will score positively under the ISS and Glass Lewis methodologies, and then restructure them if an early analysis suggests a negative recommendation. Governance attorneys and consultants advise boards on governance practices such as board composition, committee structures, bylaws, shareholder rights plans, and advance notice provisions, all of which will then be evaluated by proxy advisors.

In a contested proxy situation, there is an order of magnitude increase in compliance and governance costs. Firms must retain proxy solicitation firms on an intensive basis, often paying millions rather than the routine retainer. Companies must prepare detailed proxy materials to rebut the activist case, often running into hundreds of pages. The firm must communicate repeatedly with institutional shareholders, and retain financial advisors to prepare analysis of the company's strategic position and the activist proposals. Even though an activist may structure a campaign on the weakest point of an incumbent board's record, the company must still defend the firm's entire front, while simultaneously running the business. This is compounded by proxy advisors ISS and Glass Lewis that prepare formal proxy contest analyses including detailed reports evaluating the activist's thesis and the company's defense, to which the company must respond in very tight time frames. As proxy advisors issue these reports typically about three weeks before the annual meeting, the target company has limited time to identify factual errors, prepare formal responses, and distribute those responses to shareholders before voting begins. In some cases, there are additional costs when a target firm subpoenas the proxy advisory firms for their communications with institutional shareholders.

A final set of compliance costs relates to the "proxy advisor feedback loop" as proxy advisory firms historically offered governance consulting services to the same companies they rate, albeit through a separate business unit. Many companies felt compelled to purchase those consulting services as a form of insurance against negative recommendations. Although proxy advisors maintain that there are appropriate information barriers between the rating and consulting functions, this relationship is under scrutiny by federal and state regulators.

Homogenization of Corporate Governance

Proxy advisors ISS and Glass Lewis' annual governance guidelines set a de facto regulatory standard for public companies. While their published guidelines are not enforceable by law, there is a near-mandatory practical effect because institutional investors follow advisor recommendations closely, and activist investors are standing by to intervene. Companies that deviate from those standards may face vote-against recommendations on directors, executive compensation, or other governance proposals. Taken together, there is a homogenization of corporate strategy that follows from standardized governance. When ISS and Glass Lewis apply the same governance templates across thousands of companies, and when the institutional investors vote those templates through their proxy decisions, the implicit message to corporate boards is that certain strategies, capital structures, and executive pay designs are "acceptable" and others will invite governance penalties. This creates a form of competitive convergence such that firms in different industries with genuinely different competitive situations end up with similar board compositions, capital allocation frameworks, executive incentive structures, and investor relations practices. For example, a study of all entrepreneurial firm IPOs in the US from 1990 to 2020 revealed that, just prior to an IPO, a firm was more likely to add gender diversity to conform to public investor norms (Kenney, Patton, & Terjesen, 2024), despite a large body of research indicating that gender diversity does not improve firm performance (Terjesen, 2023). When everyone is optimizing for the same governance scorecard, strategic differentiation—a key engine of competition—is implicitly penalized. This effectively results in a dominant corporate governance logic, where only a variety of firm and institutional factors may lead to some deviance (Aguilera, Judge, & Terjesen, 2018).

The long-run consequence may be industries populated by firms that are all reasonably well-governed by standard metrics but none of which is positioned to make the kind of idiosyncratic, long-horizon, governance-unconventional bets that produce transformative competitive change. The irony is that many of the U.S.' most consequential competitive developments (e.g., Amazon's long loss-making investment phase, Apple's product concentration strategy, and Netflix's pivot to streaming) would have appeared problematic through a standard proxy advisor governance lens at the time they were happening.

Erosion of Accountability and Transparency

Although proxy advisors and activists justify their existence as accountability mechanisms, a growing body of research indicates that they produce accountability deficits that may be more structurally entrenched than the management entrenchment that they claim to correct.

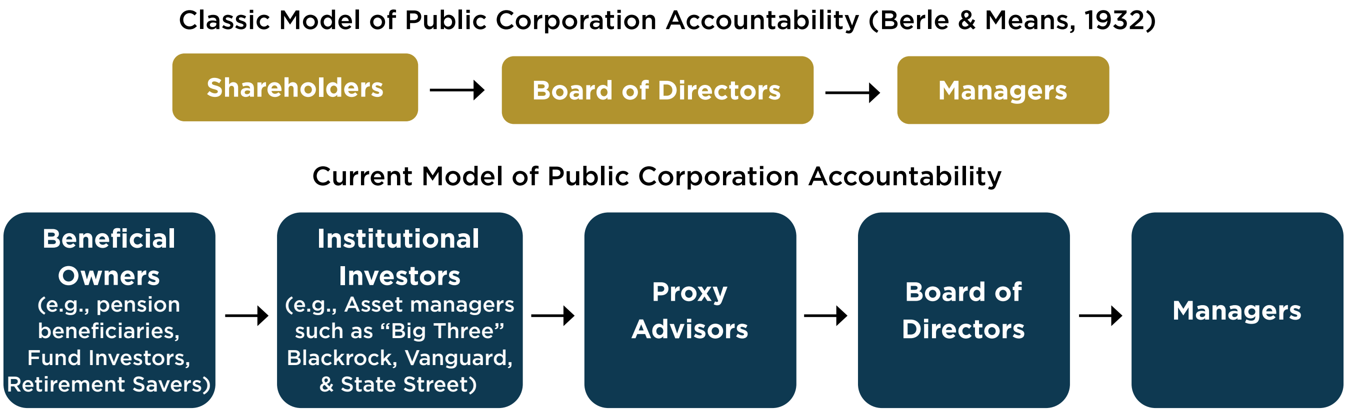
To understand how the accountability chain with proxy advisors and institutional investors is deeply opaque, largely unaccountable, and subject to conflicts of interest, we must first examine the classic Berle and Means (1932) model of a public corporation whereby accountability runs from shareholders to board of directors to managers. The board is supposed to represent shareholder interests, hire and fire management, determine executive compensation, set strategy at a high level, ensure adequate disclosure, while shareholders discipline the board through voting and exit. But today's corporate governance accountability chain looks like: beneficial owners (pension beneficiaries, index fund investors, and retirement savers) to institutional investors (asset managers) to proxy advisors to board to managers. Figure 2 illustrates the two models.

In today's model, a typical retirement saver whose pension votes at annual meetings has no knowledge of, input into, or recourse against voting decisions that are made in his/her name. This characterization applies most accurately to small and mid-tier institutional investors. The three largest index fund managers—BlackRock, Vanguard, and State Street—maintain substantial independent governance teams and exercise meaningful independent judgment on many voting decisions. Vanguard in particular has a documented policy of skepticism toward activist campaigns and has not publicly supported an activist campaign for share price or capital allocation reasons since at least 2022. Among smaller mutual funds, however, proxy advisor dependence is substantial: robo-voting reached 33% of all mutual fund votes by 2021 (Matsusaka & Shu, 2024). Taken together, the nominal principals (i.e., beneficial owners) exercise essentially no oversight over the agents who exercise control rights in their names.

Institutional investors, overseeing portfolios of thousands of companies, cannot feasibly conduct independent governance research on each holding and therefore delegate this function, formally or informally, to proxy advisory firms. The frequency with which recommendations are closely followed or robo-voted underscores a lack of transparency in both the process and its underlying methodologies.

And finally, proxy advisors have no fiduciary duty to the companies they rate or the shareholders who rely on their recommendations. These proxy advisory firms sell analytical services, with very limited liability for erroneous or negligent recommendations. By contrast, public companies' directors and officers are subject to fiduciary duties that are enforceable through shareholder litigation.

FIGURE 2: CLASSIC AND CURRENT MODELS OF PUBLIC CORPORATION ACCOUNTABILITY



Source: Elbra, O'Brien, & Boersma (2025)

Activist investors have a different but complementary accountability problem as they claim to act on behalf of all shareholders. Their campaigns typically invoke the language of governance and accountability, but their actual accountability is minimal. During a proxy campaign, activists communicate intensively with institutional shareholders about their analysis of company weaknesses and proposed changes to governance. These communications are exempt from many fair disclosure requirements that govern company communication with shareholders, leading to a theory that the activist is soliciting votes rather than trading on material non-public information. Moreover, activist investors typically exit positions within one to three years of a campaign launch. After an exit, these activist firms have no ongoing accountability for the consequences of the governance changes they imposed.

At the board level, proxy advisor and activist influence can erode board authority and accountability. Proxy advisor guidelines effectively dictate board composition requirements, committee structures, and executive pay design, such that the board has very little actual discretion. Director quality can deteriorate when proxy advisor ‘overboarding’ guidelines—and, in some cases, qualitative assessments of director refreshment—penalize directors who serve on multiple boards, even though those directors often possess the most extensive knowledge of a company’s business. Aware that proxy advisors will evaluate their decisions, board discussions may become chilled, and boards may be less willing to approve governance arrangements that make strategic sense for their company but deviate from norms.

Social and Broader Economic Harms

Beyond the direct financial and compliance costs already discussed, short-horizon activist pressure can destroy long-run value in ways that fall outside the metrics activists and their institutional followers optimize against. Those costs land on a firm’s own long-term owners first, and on workers, communities, and the broader innovation base.

Activist campaigns frequently target labor costs, and the empirical record here is more nuanced than either side's rhetoric. Studies of hedge fund activism find that targeted firms achieve measurable gains in plant-level productivity, while employee wages and work hours do not keep pace and employment growth slows (Brav, Jiang, & Kim, 2015; Denes, Karpoff, & McWilliams, 2017). Full-time positions may be replaced by contract, gig, or outsourced arrangements with fewer benefits and less security, and defined-benefit pension obligations may be frozen or converted to defined-contribution plans. The productivity gains are real; the contested question is distributional and temporal: who captures the gains, and whether reductions that improve near-term metrics also forgo firm-specific human capital that sustains the firm's long-run value.

These costs concentrate geographically. A restructuring that produces a modest, near-term improvement in return on assets for a diversified institutional portfolio can impose severe local consequences including job losses, a reduced tax base, downstream effects on suppliers and service businesses, and population decline. Two features of the activism model make this externalization systematic. First, activists and the institutions that follow them hold diversified, often short-horizon portfolios, so the concentrated local costs of any single campaign, and any long-run damage to the specific firm, are invisible against portfolio-level returns. Second, the metrics that drive these campaigns capture near-term financial performance, not the firm-specific capabilities, relationships, and reputation a closure may destroy. Where a restructuring genuinely enhances the long-run value of the firm, it is the market reallocating capital as it should. The concern is the subset of interventions that book short-term gains while eroding durable firm value and exporting uncompensated costs onto third parties, a wealth transfer and an externality rather than value creation. The same short-horizon pressure reaches innovation. Following activist targeting, firms reduce R&D investment (Watson, How, & Verhoeven, 2024). At the level of an individual firm this may sometimes be warranted discipline on wasteful spending; in aggregate, however, sustained pressure to cut R&D in favor of near-term returns sacrifices both the long-run value of the firms themselves and the broader social returns to innovation such as new products, processes, and knowledge that spill beyond any single firm. This is the clearest case in which short-term metric improvement and long-run value diverge.

Anti-Competitive Weaponization of the Proxy System

A less commonly examined but structurally significant concern is the potential for proxy mechanisms to be used by parties with competitive or strategic interests, rather than purely financial governance interests. The governance infrastructure of proxy advisors, institutional investors, and activist campaigns is typically characterized as a check on entrenched management. The same machinery can, however, be deployed by parties whose primary motivation is strategic rather than shareholder-value-based, and the current regulatory framework has no mechanism for distinguishing between the two.

The clearest documented example is the 2010-2011 Air Products and Chemicals hostile takeover campaign against Airgas. Air Products made a series of increasingly large acquisition bids for Airgas, each rejected by the Airgas board as inadequate. Unable to negotiate an acceptable deal, Air Products launched a proxy contest specifically designed to elect directors who would vote to accept the acquisition. Air Products succeeded in winning board seats. The newly elected directors, however, fulfilled their independent fiduciary obligations once seated, reviewed the offer on the merits, and voted against accepting it. These directors concluded, as the Airgas board had, that Air Products' bid undervalued the company. The Delaware Court of Chancery upheld Airgas's poison pill defense in a landmark opinion, and Air Products ultimately abandoned the campaign. The case illustrates both the availability of proxy mechanisms to strategic parties and a structural limit on that mechanism: directors, once seated, owe fiduciary duties to the company and its shareholders, not to the party that nominated them.

The Air Products/Airgas dynamic of a strategic party using proxy machinery to pursue competitive objectives is less exceptional than it might appear. Acquirers in hostile takeover situations routinely use proxy contests as a complement to tender offers, precisely because replacing resistant board members is often the path of least resistance when a target board is rejecting a bid. This is proxy mechanism use for competitive or strategic purposes, not purely governance improvement purposes, and the existing regulatory framework treats it identically to a financial activist campaign focused on operational improvement.

The more speculative, but structurally plausible, concern is whether this dynamic could extend beyond acquisition contexts: whether a dominant incumbent could use proxy machinery not to acquire a rival outright but to install sympathetic board members who would constrain the rival's competitive strategy. This scenario is hypothetical; well-documented cases of this specific pattern are not in the public record. The Air Products case also illustrates why the mechanism is less reliable for such purposes than it might appear. Directors' independent fiduciary duties are a genuine constraint that limits a strategic nominator's ability to direct board outcomes once nominees are seated. Nevertheless, the structural vulnerability is real: the proxy advisory system has no mechanism for asking whether a campaign serves competitive suppression rather than shareholder value, and no disclosure framework that would surface a nominating party's competitive interests in a target company. Reforms that require fuller disclosure of a nominating party's relationship to the target company, including any direct or indirect competitive relationship, would address this gap without requiring the regulatory system to make judgments about campaign motivation that it is poorly positioned to make.

National Security Implications

The opacity and unaccountability of the proxy advisory system create a distinct national security vulnerability that has received insufficient attention. Because some institutional investors, particularly smaller mutual funds, delegate governance decisions to proxy advisors with limited independent review (Matsusaka & Shu, 2024), the proxy advisory channel represents a low-visibility pathway through which foreign adversaries or their proxies can seek to influence the strategic direction and governance of American companies in critical industries.

Consider a scenario well within the documented range of current activist practice: a hedge fund with investment from a sovereign wealth fund affiliated with a foreign government. For example, a Chinese state-linked investment vehicle operating through a series of intermediary funds to obscure its ultimate beneficial ownership, or a Russian-affiliated family office routed through a European financial center launches a campaign targeting a U.S. critical minerals mining company or domestic energy producer, demanding that it reduce domestic production in favor of capital returns, divest certain processing assets, or restructure its board in ways that weaken the company's ability to execute long-term supply chain strategies. The strategic logic is straightforward: constraining U.S. domestic production of critical minerals preserves Chinese or Russian market dominance in those supply chains, and doing so through the governance channel is far less visible than direct acquisition or lobbying.

The hedge fund files a Schedule 13D, campaigns for board representation, and solicits institutional investor support. Proxy advisors evaluate the campaign using standardized governance criteria that focus on near-term shareholder returns and board independence metrics, without any mechanism for assessing whether the campaign serves a foreign strategic interest adverse to U.S. national security. Smaller and mid-tier institutional investors, which rely heavily on proxy advisor recommendations as a matter of operational practice, support the campaign. Larger index fund managers may exercise greater independent judgment, but the structural vulnerability created by proxy advisor duopoly influence over the remaining market remains significant.

The result is a governance change at a strategically significant company driven, at least in part, by foreign-affiliated capital operating through the permissive opacity of the activist and proxy advisory channels. The Committee on Foreign Investment in the United States (CFIUS) has no jurisdiction because no controlling ownership stake changes hands. The SEC's disclosure framework captures the activist's ownership stake but not the ultimate beneficial owners of the sovereign fund's investment. The proxy advisors' recommendations are issued without any national security review or disclosure obligation. The existing regulatory architecture governing proxy advisors and activist investors was designed for a world in which the primary governance threat was domestic management entrenchment, not adversarial foreign influence channeled through the capital markets. Reforms must close this gap explicitly.

The December 2025 White House Executive Order on proxy advisors explicitly flagged the risk posed by "foreign-owned" proxy advisory firms. Both ISS and Glass Lewis have significant foreign ownership or foreign client bases, and ISS is majority-owned by the German exchange operator Deutsche Börse AG. While direct attribution of specific governance campaigns to foreign strategic interests is difficult given current disclosure frameworks, the structural vulnerability is clear. Reforms that require disclosure of the ultimate beneficial ownership of activist fund investors, that establish national security review procedures for activist campaigns targeting critical infrastructure or defense supply chain companies, and that impose transparency requirements on proxy advisors' foreign ownership and client relationships would begin to close the gap between the current regulatory architecture and the actual threat environment.

Section 6: Empirical Evidence: Methodology, Data, and Topic Gaps

Although finance, economics, law, and corporate governance research has grown rapidly, and spotlights many issues, progress is uneven and characterized by glaring gaps in methodology, data, and topic.

Methodology Gaps

As described earlier, a large body of empirical research reports that proxy advisors notably influence shareholder voting outcomes for director elections, say-on-pay proposals, shareholder activism campaigns, and ESG-related resolutions.

This empirical work typically relies on event study methods (i.e., measuring stock price reactions around the public announcement of an activist campaign) or matched-sample comparisons (i.e., comparing a set of target firms to a set of control firms). Both approaches have well-known limitations. Event studies capture market expectation of activist impact, but not actual long-run changes in value. These studies can be contaminated by the possibility that activists target already-improving firms. Matched-sample studies cannot fully control for the non-random selection of activist targets, meaning that observed differences between target and non-target firms may reflect pre-existing characteristics rather than actual causal effects of activism. Future research should develop better causal identification strategies through natural experiments, regulatory discontinuities, or improved econometric methods.

There are also transparency gaps in how proxy advisor methodologies are applied. While ISS and Glass Lewis publish their benchmark voting policy documents, the detailed analytical reasoning behind individual company-level recommendations, including the specific weighting of factors, proprietary data models, and internal scoring, is accessible only to subscribers and is not subject to independent verification or audit. A small but growing literature examines whether specific proxy advisor governance criteria (e.g., for board independence requirements, director tenure limits, say-on-pay frameworks) actually predict firm performance, with the results not consistently supportive of proxy advisor methodologies.

Data Gaps

There are also significant data gaps, due to censoring the data too early (i.e., "survivorship bias") or too late (i.e., short term observations). Empirical studies are based on activism campaigns that become public through 13D filings, press releases, or proxy contest filings, and thus ignore the considerable amount of behind-the-scenes engagement between activists and companies that is resolved privately before becoming public. The publicly observable sample may suffer from survivorship bias and is likely non-representative of the full population of activist interactions, and thus conclusions are not generalizable.

Activist outcome studies frequently use three-to-five year observation windows following a campaign, which may be insufficient to capture long-run effects on innovation, competitive position, and stakeholder welfare. These harms may manifest over greater time horizons, for example reduced R&D investments leading to competitive disadvantages or workforce capabilities eroding gradually until organizational decline.

Topic Gaps

There are many under-researched topics including costs of activism, private settlement ecosystem, downstream effects of proxy advisor errors, long-run effects on industry structure, and international comparisons.

Despite the significant costs of activism, there is no comprehensive study that attempts to measure the total social cost of activist campaigns such as direct compliance costs, management distraction, employee welfare effects, community impacts, and long-run competitive consequences. These costs would then be weighed against the financial returns generated for activist investors and other shareholders. The existing literature tends to study individual cost categories in isolation, making it impossible to construct an aggregate welfare assessment.

The empirical literature indicates that the vast majority (i.e., 80 to 90 percent) of activist campaigns are resolved through private settlements rather than full proxy contests. While settlement terms are disclosed to the SEC through 8-K filings, the full negotiating history, the range of terms considered, internal communications that shaped outcomes, and the actual implementation of settlement commitments are not in the public record and are not systematically tracked. There is very little scholarly discussion of the distribution of settlement terms, the factors that determine settlement versus contest, the relative outcomes for different stakeholder groups under settled versus contested campaigns, or the dynamics of pre-settlement negotiations. It should be noted that proxy advisors typically become formally involved only after a proxy contest is filed; their role in shaping settlement is indirect, through the parties' assessments of likely proxy advisor recommendations rather than direct participation in negotiations.

There is also a lack of research on the effect of factual errors in proxy advisor reports, such as misstatements of financial data, incorrect peer group compositions, and mischaracterizations of governance practices. These errors' downstream effects on voting outcomes, firm value, and governance decisions have not been systematically studied. We don't know how often errors affect vote margins, whether companies that identify and correct errors do better at the ballot box, or whether the error rate varies systematically across company types, industries, or governance situations.

Despite empirical evidence that institutional ownership concentration reduces competitive intensity (see Azar, Schmalz, & Tecu, 2018, for foundational evidence), we lack an understanding of the long-run effects of activism and proxy advisor standardization on industry structure in the form of market concentration, entry rates, innovation competition, geographic dispersion of economic activity.

There is also an under-explored international comparative dimension. Most empirical literature on activism and proxy advisors focuses on U.S. markets, with some work in the U.K. and Canada, notably indicating that proxy advisors have weaker power in the U.K. than in the U.S. (Tuch, 2019). A large body of comparative corporate governance identifies very different governance regimes such as German codetermination, Japanese cross-shareholding, French blocking shareholder structures, and Scandinavian state ownership. Comparative analyses could help us determine which effects are attributable to activism versus which are specific to the U.S. governance environment, and can illuminate whether alternative governance arrangements produce better outcomes.

Section 7: Counterarguments & Responses

There are many arguments favoring activists and proxy advisors, typically highlighting their roles as valuable contributors to corporate governance and shareholder accountability, which can also be refuted.

Common Arguments in Favor of Activists & Proxy Advisors

Advocates for proxy advisors point to the provision of standardized, cost-effective, and expert analysis of a range of governance issues. Proxy advisors recommendations enable consistency and benchmarking across companies, with the goal of facilitating easier comparisons and reducing information asymmetry. Common arguments for proxy advisors and activists highlight the potential for management entrenchment and captured boards that then impose significant costs on shareholders and the broader economy. Facing no credible challenge to their control, CEOs may overpay themselves, resist value-enhancing strategic changes, make empire-building acquisitions, and perpetuate organizational structures that serve their personal interests rather than those of shareholders. Although the board of directors is theoretically the accountability mechanism for management, some boards can be ineffective monitors due to CEO duality, being populated by management allies, dependent on CEO goodwill for their positions, and lacking the information and incentives to challenge management decisions. Another common argument is that small and medium institutional investors are now armed with some advice and can influence corporate governance at large firms.

What Are the Responses to These Arguments?

Although proxy advisor reporting is standardized and can be cost-effective for some firms, their recommendations tend to be overly standardized or "one-size-fits-all." That is, proxy-advisors' recommendations can fail to consider company-specific contexts, strategies, or long-term goals, which can lead to suboptimal governance decisions and short-termism. Conflicts of interest may arise when proxy advisory firms provide consulting services to companies they also evaluate. Furthermore, as two proxy advisors collectively distribute these recommendations to 97-98% of the market, proxy advisors exert outsized influence over shareholder voting, without sufficient transparency or accountability themselves.

Although proxy advisors and activist investors purport to resolve "market failures," they may create them by prioritizing immediate financial gains or political goals over sustainable, long-term value creation. As for small and medium institutional investors, new technologies such as AI may provide cost-effective, customizable recommendations of higher quality.

Section 8: Policy Recommendations & Reforms

The current corporate governance environment requires comprehensive reform. Critically, effective reform does not depend solely on action in Washington. The following recommendations are organized around three distinct audiences, each of which has independent authority to act and each of which is essential to a durable solution. First, the SEC and executive branch can move administratively, through rulemaking, guidance, and enforcement, without waiting for congressional action. Second, Congress can pursue legislative remedies such as new statutory frameworks, registration requirements, and private rights of action that would provide more durable

and comprehensive reform than administrative action alone. While the reform of fiduciary duty and institutional investor accountability could be achieved by Congress, the voting power of passive funds might be accomplished by Congress or the SEC. Third, non-federal actors including state attorneys general, state pension trustees, institutional investors, and market participants can act independently within their existing authority, and their actions are particularly significant given that the federal constitutional questions raised in Texas S.B. 2337 litigation may limit the direct reach of some state regulatory approaches.

SEC and Executive Branch: Administrative Remedies
At the federal level, the White House's (2025) Executive Order "Protecting American Investors From Foreign-Owned and Politically Motivated Proxy Advisors" spotlights that "proxy advisors wield enormous influence over corporate governance matters, including shareholder proposals, board composition, and executive compensation, as well as capital markets and the value of Americans' investments" and seeks to "increase oversight of and take action to restore public confidence in the proxy advisor industry, including by promoting accountability, transparency, and competition." There is a mandate that the Securities and Exchange Commission (SEC) Chair "review all rules, regulations, guidance, bulletins and memoranda relating to proxy advisors." The SEC has shown it will also act on its own authority in adjacent areas: its May 2026 proposal to permit optional semiannual reporting

(discussed below in reporting-cycle reforms) is one example already underway (U.S. Securities and Exchange Commission, 2026). The Executive Order was issued after many committee hearings (U.S. House Committee on Financial Services, 2025). While traditionally the SEC regulated proxy advisors, there were recent court rulings that limited the SEC authority, and led to regulatory uncertainty. There are also some congressional proposals such as the Corporate Governance Fairness Act which would impose registration, disclosure, and conflict-of-interest rules on proxy advisors, but full enactment remains pending.

Responding to regulatory gaps at the federal level, several states have taken actions against proxy advisors (Bennett, Clayton, Formont, & Long, 2024). These actions are typically based on two arguments: proxy advisors advance environmental and social policy objectives rather than economic interests, especially for state pensions, and an unaccountable private power over public companies incorporated or headquartered in the state. These two motivations frequently appear together in the same state legislation.

To date, the most significant state legislation targeting proxy advisors is Texas Senate Bill 2337 which was signed into law in June 2025. Texas S.B. No. 2337 (2025) requires any proxy advisory firms doing business in Texas to disclose when recommendations rely on ESG or DEI factors, to provide companies with advance copies of proxy reports and an opportunity to respond before recommendations are finalized, and to disclose conflicts of interest including consulting relationships with companies being rated. ISS and Glass Lewis both sued to block the law, arguing that the state law was preempted by federal securities law (i.e., the Securities Exchange Act of 1934 and SEC rules governing proxy solicitation) and also that the state law imposed unconstitutional burdens on their First Amendment rights as publishers of investment research. A federal judge issued a preliminary injunction in August 2025 on the basis that the proxy advisors are likely to succeed on their First Amendment compelled-speech and unconstitutional-vagueness claims; the court did not rest the injunction on the preemption argument, which remains unresolved. If these constitutional objections hold broadly, state legislative action against proxy advisors may be foreclosed regardless of policy merits, pushing the regulatory question back to the federal level.

The state of North Dakota passed H.B. 1458 which requires proxy advisors providing services to state pension funds to disclose their methodologies, conflicts of interest, and the basis for recommendations that deviate from a company's stated position. As the North Dakota law is framed as a fiduciary protection measure for state retirement systems rather than a direct regulation of proxy advisors, this argument may avoid the compelled-speech concerns in the Texas regulation.

Regulatory Oversight

As illustrated in the above example of federal and state playbooks, comprehensive reform will require coordinated action across multiple regulatory domains, and the political economy of reform is complicated by the fact that the most powerful beneficiaries of the current system (i.e., large institutional investors, activist investors, and proxy advisory firms) have substantial resources to resist change and sophisticated regulatory engagement capabilities. A reform may be necessary to clarify the SEC's authority through formal rulemaking rather than through guidance documents and interpretative releases. At a minimum, this rule should include formal registration requirements for proxy advisors, conduct standards for conflicts of interest, methodological disclosure obligations, error correction procedures, advance company review rights, and periodic examination authority. A dedicated proxy advisory oversight program is also needed.

Increased Transparency

Reforms must lead to increased transparency for proxy advisors and activist investors.

For proxy advisors, transparency reforms should include clear disclosure of methodologies, data sources, voting recommendations, and any conflicts of interest, especially when advisors provide consulting services to companies they also evaluate. The most widely discussed regulatory reform is to subject proxy advisors to formal registration, oversight, and conduct standards under the Securities Exchange Act, either as investment advisers under the Investment Advisers Act or under a dedicated regulatory framework. As the SEC's 2019 guidance and 2020 proposed rules moved in this direction but were not fully implemented, proxy advisors' regulatory status remains ambiguous. This formal registration requirement would enable the SEC to impose substantive conduct standards (e.g., conflict of interest management, methodological disclosure, error correction procedures, advance review rights for rated companies) and then enforce those standards through examination authority. This would address many transparency and accountability deficits without requiring Congress to act, since the SEC has sufficient existing authority to regulate proxy advisors under the proxy rules.

In the case of ISS which has a dual role as both proxy advisor and governance consultant, this discrete structural problem should be addressed through a targeted regulatory prohibition. All proxy advisors, particularly the ISS, should separate advisory and consulting businesses through divestiture or through structural separation with genuine information barriers to eliminate the most obvious conflict without requiring a comprehensive regulatory overhaul.

To increase transparency for activist investors, many reforms are possible. First, the 5% ownership window of ten days to disclose position and intentions could be shortened to one or two days. This has been proposed by the SEC and implemented in the UK. A shorter window reduces the informational asymmetry that systematically advantages activist position-building over target company and other shareholder transparency.

As activists sometimes engage with institutional investors during formal proxy contest periods, and in some cases may align on governance demands through less formal channels, short of formal coordination agreements that would trigger group disclosure requirements under Section 13(d), the existing legal standard for "group" could be modified. Reforms could clarify and broaden the definition of acting in concert to improve transparency about actual ownership and governance dynamics in contested situations.

A final key reform for activist investors is requiring disclosure for activist investors' full economic exposure. Activist investors sometimes hold economic positions that are more complex than their reported ownership stake suggests, for example because of derivatives, short positions in related securities, or other instruments that create economic incentives that diverge from those of ordinary long shareholders. An activist that holds a significant short position in a company's debt while mounting an equity campaign, for example, has economic incentives that differ materially from those of ordinary equity holders but that are not reflected in standard 13D disclosures. Although the SEC has taken some steps in this direction, a comprehensive disclosure framework for complex derivative positions remains incomplete.

Congress: Legislative Remedies

Reform of Fiduciary Duty and Institutional Investor Accountability

The most fundamental reform proposal is to extend fiduciary duty to proxy advisors. As described above, proxy advisors currently owe no fiduciary duty to the companies they rate, the shareholders who rely on their recommendations, nor to the beneficial owners whose savings are ultimately affected by governance decisions shaped by their recommendations.

A reform should impose fiduciary obligations on proxy advisors running to the ultimate beneficial owners— that is, the pension beneficiaries, retirement savers, and index fund investors whose savings are affected by governance decisions, rather than solely to the institutional investor clients who pay the advisory fee. Proxy advisors are hired by institutional investors, not by rated companies; the fiduciary gap is therefore most precisely described as the absence of a duty to the beneficial owners two steps removed from the governance decision. Such a reform would not only require proxy advisors to show that their criteria are grounded in evidence, but also give companies and shareholders a legal recourse when proxy advisor errors or conflicts demonstrably affect vote outcomes.

A particularly important and market-consistent complement to fiduciary duty reform is the creation of a private right of action against proxy advisors for negligent or conflicted recommendations. Under current law, proxy advisors face no private liability for recommendations that are factually erroneous, methodologically unsound, or infected by undisclosed conflicts of interest. The asymmetry is stark: public company directors and officers are subject to enforceable fiduciary duties and shareholder litigation, while the proxy advisors whose recommendations effectively direct how directors are elected face no comparable accountability mechanism. A statutory private right of action that is available to shareholders or beneficial owners who can demonstrate that a negligent or conflicted proxy advisor recommendation materially affected a governance outcome and caused demonstrable harm would introduce a direct market-based accountability mechanism without requiring ongoing SEC oversight of every recommendation. This approach is consistent with the broader framework of private enforcement in U.S. securities law and would create the kind of reputational and financial incentive for accuracy and independence that no disclosure requirement can replicate. Congress would need to create this cause of action explicitly, as courts have been reluctant to imply private rights of action from the federal securities laws in the absence of clear legislative intent. A well-designed statutory cause of action should include appropriate limitations on damages, standing requirements that focus on material harm, and safe harbors for good-faith recommendations supported by disclosed methodology, so that the remedy targets genuine negligence and conflict rather than chilling legitimate advisory activity.

Another reform would address the entire fiduciary chain from beneficial owner to corporate governance outcome. Currently, the interests of pension beneficiaries and index fund investors in governance decisions are represented through a long chain of intermediaries (i.e., asset managers, proxy advisors, institutional governance teams), none of whom are directly accountable to the ultimate principals. Voting Choice programs, which allow beneficial owners to direct how their shares are voted, have already been implemented voluntarily by BlackRock, Vanguard, State Street, and other major institutional investors. Rather than creating a new mechanism from scratch, reform should standardize, expand, and mandate participation in such programs so that beneficial owners have a practical, not merely nominal, ability to express governance preferences. This reform could go even further by creating a right for beneficial owners to express voting preferences on material governance matters (e.g., CEO pay, director elections, major strategic transactions) and requiring institutional investors to either follow those preferences or explain why they did not, thus restoring a measure of principal-agent accountability to the governance chain.

A critical limitation of existing proxy choice programs, however, is that none of the three largest index fund managers currently makes a shareholder-primacy engagement option broadly available across their client base. Mandating expansion of proxy choice programs, as proposed above, must therefore be accompanied by requirements that the menu of engagement options include shareholder-primacy frameworks. These frameworks should evaluate each proposal through the prism of fiduciary obligation to beneficial owners rather than through a predetermined ideological lens, whether left or right. Without this, proxy choice reform risks expanding nominal participation while leaving the structural asymmetry in available options intact.

Institutional investors could be held to greater standards of transparency by requiring real-time or near-real-time disclosure of proxy voting decisions, including the reasoning behind votes that deviate from stated policies or advisor recommendations. This would shift the industry from the current disclosure standards which are collected annually in an aggregated form, and are backward-looking, insufficiently granular, and not practically useful for beneficial owners seeking to hold asset managers accountable for individual governance decisions.

Another needed transparency reform is for institutional investors to disclose their communication with company management and boards. Disclosing the substance of these engagement activities would include the issues raised, commitments sought, and responses received. Taken together, these disclosures would improve transparency and reduce the information asymmetry between large institutions and smaller shareholders who cannot engage to the same degree.

Reforming the Voting Power of Passive Index Funds

A reform directed at the largest single source of intermediated voting power would address how shares held in passively managed index funds are voted. The case for doing so is both structural and normative. Structurally, because index fund managers exercise voting discretion over shares whose beneficial owners have, by the nature of passive investing, delegated security selection rather than governance judgment, the asset manager's governance team (often following proxy advisor recommendations) effectively controls roughly a quarter of the votes cast across corporate America. Normatively, a pooled investment vehicle has no inherent values of its own, and a manager that votes such shares on subjective or social grounds substitutes its own conscience for a beneficiary base whose preferences are heterogeneous and cannot be reduced to unanimous consent (Mendenhall & Packard, 2025, developing this argument in the public pension context). Several reforms, escalating in ambition, would realign this voting power with the beneficial owners who bear the economic interest.

The least disruptive reform is pass-through voting, under which advisers of passively managed funds above a de minimis ownership threshold vote in accordance with instructions received from fund investors. The INDEX Act (S.1670) would implement this through the Investment Advisers Act, applying only where an adviser controls more than one percent of a company's voting securities to limit cost and administrative burden, and the Empowering Shareholders Act of 2026 advances a parallel approach in the House. This is the statutory form of the expanded proxy-choice mandate proposed above.

A second option, mirror voting, would direct that uninstructed index fund shares be voted in the same proportion as the votes actually cast by other shareholders, so that passive funds vote the way they invest: passively, echoing the shareholders actively engaged in price discovery (Copland, 2024). Critically, mirror voting should be structured as the default for uninstructed passive shares, with a retained right to opt out, rather than defaulting to the asset manager's discretionary policy. This design choice follows from a behavioral reality: passive investors are unlikely to navigate complex voting elections, so the default determines the outcome for the overwhelming majority of shares. Mirror voting is neither novel nor untested. It has long operated in fund-of-funds arrangements under the Investment Company Act, where a fund votes its shares in proportion to other shareholders (so-called echo voting), and it is already offered as an investor election by at least one of the three largest index fund managers (Vanguard, 2024). It is also the alternative that careful analysts of the abstention-based bills have urged precisely to avoid their unintended consequences (Copland, 2025).

Mirror voting carries an important limitation that must shape its design. Because it transfers no power to non-voters but rather amplifies the relative weight of shareholders who do vote, applying it indiscriminately, particularly in proxy contests and to Rule 14a-8 proposals, risks allowing an engaged minority to determine outcomes. The corrective is to pair mirror voting with the higher proxy-contest ownership thresholds and minimum holding periods proposed below, so that the residual electorate whose votes are mirrored consists of shareholders with genuine, long-term economic stake rather than transient or nominal positions. Designed this way, mirror voting neutralizes the unaccountable discretionary bloc held by passive managers while preserving the disciplining influence of investors who have committed real capital to price discovery. A third and more far-reaching option would require passive index funds to abstain from voting while their shares continue to count toward quorum.

As proponents of this approach acknowledge, a simple abstention default risks insulating incumbent management from beneficial shareholder influence, so any such rule would need to work carefully through how default abstention is treated and could be paired with a mechanism empowering a company's existing shareholders to adjust, through the bylaws, the treatment of those abstentions (Copland, 2024). Because the bylaw mechanism operates through state corporate law rather than federal securities regulation, it offers a route that may be less vulnerable to the federal constitutional questions now constraining state action against proxy advisors. At the furthest extreme, a broker non-vote treatment would render indexed shares non-voting altogether on the rationale that an investor who has indexed capital has effectively indexed the associated governance judgment; this option sits least comfortably with existing fiduciary obligations to vote and is included only to mark the boundary of the reform space.

Whether these reforms proceed administratively or legislatively varies by option. Pass-through and mirror voting are most cleanly enacted through amendment of the Investment Advisers Act, as the INDEX Act and the Empowering Shareholders Act contemplate, though the SEC may be able to reach certain mechanical elements through its proxy rules. The abstention-and-bylaw approach depends substantially on non-federal actors. In all cases, the decades-old echo-voting practice in fund-of-funds arrangements demonstrates that the mechanics are administrable.

Adjusting Reporting Cycles to Reduce Short-Term Pressure

Although the quarterly earnings cycle is a backbone of American public governance, reporting cycle reforms could reduce short-term pressure.

The most achievable reform would be to eliminate or restrict voluntary quarterly earnings guidance. Despite the entirely voluntary nature, quarterly earnings reporting has become nearly universal among large public companies because a failure to report could lead to higher analyst forecast dispersion and greater stock price volatility around earnings releases. The quarterly earnings guidance has led to a focus on short-term performance, and led activists to target companies with a history of missed guidance. Proxy advisors have also embedded similar assumptions in their executive compensation frameworks, which evaluate pay-for-performance alignment against annual earnings metrics. A reform could lengthen quarterly reporting to semi-annual or annual reporting to give managers and investors more time for strategic decision-making.

Reforms could also address the mandatory quarterly guidance as the SEC requires public companies to file quarterly Form 10-Q financial reports within 40 to 45 days of the end of each quarter. This mandatory disclosure obligation is the regulatory foundation of the quarterly earnings cycle and has no direct parallel in most other major capital markets. Following a review that determined that quarterly reporting requirements encourage short-termism without enhancing commensurate investor protection, the EU eliminated mandatory quarterly reporting for most companies in 2013. The UK followed with similar reforms. The SEC has now moved in this direction administratively. On May 5, 2026, the SEC proposed rule and form amendments that would permit public companies to elect semiannual reporting on a new Form 10-S in lieu of quarterly Form 10-Q reports, so that an electing company would file one semiannual report and one annual report each fiscal year rather than three quarterly reports and an annual report (U.S. Securities and Exchange Commission, 2026). The proposal is elective rather than mandatory and remains in the comment period, but it signals that the principal regulatory lever discussed here is already in motion and can be exercised by the SEC without congressional action. In addition to the aforementioned arguments for eliminating quarterly voluntary disclosure, eliminating mandatory quarterly reporting would reduce regulatory compliance costs and the frequency of short-term earnings focal points that drive activist targeting and proxy advisor performance evaluations.

The SEC's May 2026 proposal adopts the elective logic this paper advocates, but a more targeted reform would go further by differentiating reporting frequency based on company characteristics. For example, that reform could allow smaller companies, companies in long-cycle industries like biotechnology or infrastructure, and companies that elect a long-term governance framework to report semi-annually rather than quarterly. This approach preserves quarterly reporting for large, liquid, widely-held companies where the information value is greatest while reducing the compliance burden and short-term pressure on companies where quarterly reporting is most distortive. The SEC already has a tiered disclosure framework which differentiates requirements for large accelerated filers, accelerated filers, smaller reporting companies, and emerging growth companies. Reducing the cadence of backward-looking quarterly financial reporting is fully consistent with the transparency reforms urged elsewhere in this paper: the aim is to relieve the short-term earnings treadmill while increasing disclosure of who exercises governance influence and of firms' forward-looking long-term strategy. This could provide a template for this differentiated approach.

A related reform would require public companies to disclose long-term (i.e., five to ten year) strategic plans alongside annual financial reports. The UK's strategic report requirement requires companies to describe their business model, strategy, and principal risks in a forward-looking narrative that complements the annual financial statements, and is a model of this reform. Although the SEC's existing Management Discussion and Analysis requirements already include some forward-looking elements, they are primarily backward-looking financial commentaries rather than genuine long-horizon strategic plans. Strengthening the forward-looking strategic disclosure requirement would extend the time horizon of governance accountability in ways that reduce activist and proxy advisor leverage over near-term performance.

Another key reform would involve restructuring the American proxy season timeline which is concentrated from April to June. During this very short time period, companies must file proxy statements, engage with institutional investors, respond to proxy advisor reports, and conduct annual meetings, creating time pressure that reduces the quality of governance deliberation and limits companies' ability to respond effectively to activist campaigns or proxy advisor negative recommendations. A reform could spread annual meetings more evenly across the calendar year to reduce the concentration of governance events that overloads institutional investor and proxy advisor analytical capacity, potentially improving the quality of governance decisions and giving companies more time to engage meaningfully with shareholders before votes are cast.

A final key reform is extending the time between proxy advisor report publication and the annual meeting vote which is currently about three weeks. A greater time horizon would give companies more opportunity to identify and correct errors in proxy reports, engage with institutional investors about specific recommendations, and provide additional context for governance decisions that proxy advisors have evaluated negatively.

Non-Federal Actors: State Attorneys General, Institutional Investors, and Market Participants

Governance & Voting Rules

Governance and voting rules that currently govern proxy contests, shareholder proposals, and institutional investor voting were designed for an earlier era where activist investors were rare, proxy advisors did not exist in their current form, and the dominant governance problem was management entrenchment rather than short-term shareholder pressure. There are many worthy reforms.

The first key reform is to set a higher minimum ownership threshold for proxy contest rights. In effect since September 1, 2022, the Universal Proxy Card rules make proxy contests accessible to shareholders with very small ownership stakes. For example, the activist Strategic Organizing Center (SOC) is a coalition of labor unions including Service Employees International Union (SEIU) and owned only $16,000 of Starbucks' $105 billion market capitalization. Citing human capital mismanagement that included failures in racial equity and fair labor practices for a diverse, hourly workforce, SOC nominated three board directors to Starbucks, but then settled for other concessions. A reform establishing minimum ownership thresholds for shareholders seeking to mount full proxy contests would calibrate governance rights to economic stake in a way that preserves accountability while reducing the potential for campaigns motivated by agendas that do not align with the interests of genuine long-term shareholders. The challenge is setting thresholds that exclude frivolous or agenda-driven campaigns without blocking legitimate minority shareholder voice.

A related reform would create a minimum holding period requirement for institutional governance rights such that shareholders must hold their position for at least one to three years before gaining access to director nomination rights. This could reduce the leverage of activist funds with short holding horizons while preserving governance rights for long-term investors. Extending minimum holding period requirements to proxy contest nominations, and not just proxy access nominations, would realign governance rights with long-term ownership interest.

Market-Based Solutions

There is a strong case for market-based solutions as many governance problems attributed to proxy advisors and activist investors are themselves the product of those entities' own market failures, e.g., rational ignorance among beneficial owners, economies of scale in governance research that produce natural monopoly tendencies in proxy advisory services, and coordination problems among dispersed shareholders that activism partially solves. Market-based solutions that address these underlying failures directly, rather than layering regulatory requirements on top of them, may produce more durable and efficient outcomes.

Market-based solutions do not require congressional action or SEC rulemaking, and are less vulnerable to regulatory reversal under successive administrations. These solutions can be implemented incrementally by private actors without waiting for the political conditions necessary for comprehensive regulatory reform. The most effective reform strategies in corporate governance typically combine regulatory and market-based approaches by using regulation to establish minimum standards while relying on market mechanisms to drive continuous improvement beyond those minimums.

Another clear market-based solution is to develop credible alternative advisory services that compete with ISS and Glass Lewis on methodology, accuracy, and value to institutional investors, broadly or with a focus on a particular market such as long-term focused advisory services for pension funds.

While several small proxy advisory firms exist, none have achieved significant market share in the U.S. Institutional investors could develop and fund alternative advisory services, as J.P. Morgan recently did with its in-house Proxy IQ.

Another market-based solution is a venue for trading public company shares that imposes governance requirements specifically designed to promote long-term value creation and reduce short-term shareholder pressure. The Long-Term Stock Exchange (LTSE) received SEC approval as a national securities exchange in 2019 and has listed a small number of technology companies under governance standards that include tiered voting rights based on holding period, long-term executive compensation structures, and stakeholder engagement requirements. While the LTSE remains early-stage, its model demonstrates that market participants can create governance environments that reward long-term ownership without waiting for regulatory action.

A related and under-addressed market gap exists at the level of advisory content rather than investor infrastructure: no broadly available advisory framework currently offers institutional investors a shareholder-primacy-grounded alternative to the ESG-oriented default recommendations of ISS and Glass Lewis. Several smaller advisory providers offer research grounded in shareholder primacy and skeptical of non-fiduciary governance agendas; however, none has been integrated into the proxy choice programs offered by the largest index fund managers. While nascent progress exists in the form of one major index fund manager offering such an option to a subset of government clients, this remains far from the broad accessibility that would give beneficial owners a meaningful choice. The practical consequence is visible in vote tallies on well-grounded conservative shareholder proposals, which receive low vote counts not because the underlying positions lack shareholder support, but because the proxy choice architecture provides no practical mechanism for beneficial owners aligned with shareholder primacy to register that preference. Market-based reform should include active efforts by index fund managers to incorporate shareholder-primacy advisory options into their proxy choice programs, making the menu genuinely pluralistic rather than directionally uniform. The absence of such options is not a natural market equilibrium. It is a design choice that reform can correct.

Conclusion

Ultimately, the interaction among proxy advisors, activist investors, and corporate boards defines much of the modern governance landscape. When each party operates responsibly, the result can be a healthy balance that fosters transparency, accountability, and sustainable value creation. But when any actor overreaches—whether through excessive activism, defensive corporate tactics, or opaque advisory influence—the balance tilts, and trust erodes. Ensuring open communication, accurate information, and equitable participation in governance decisions remains essential to maintaining confidence in capital markets and protecting long-term shareholder interests.

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