

Institute of Corporate Directors

Podcast Topic: Be It Resolved: Proxy Advisors Are Another Victim of AI

Rahul Bhardwaj (0:06 - 2:48): Welcome to Be It Resolved, season two, where bold ideas meet courageous leadership. I'm Rahul Bhardwaj, president and CEO of the Institute of Corporate Directors. Each episode explores the issues that influence directors, governance, and decision-making in the boardroom.

My guest today is Victor Li, executive vice president, governance advisory at Kingsdale Advisors. He's a senior advisor to boards and institutional investors on shareholder-sensitive governance decisions, activist defense, and contested M&As, with more than two decades of experience in corporate governance and capital markets. Victor founded and led Kingsdale's governance advisory practice and spent four years at institutional shareholder services.

May have heard of them, ISS, who's working directly with global institutional investors on proxy voting and engagement. Victor, welcome. Pleasure.

Today's resolution is Be It Resolved: Proxy Advisors Are Another Victim of AI. Which way will you vote? Victor, a little later I'm going to come to you.

You're going to get to vote as well. Today, we examine how the use of AI and proxy voting is influencing stewardship and corporate governance practices. JP Morgan's decision to use an internal AI-driven tool in place of proxy advisors raises important questions for boards, investors, and public companies.

We'll explore what this development may signal for oversight, accountability, and decision-making, especially for directors. And keep in mind, we're also under the backdrop of a White House executive order, one that in fact instructed the federal regulator to look into the role of proxy advisor within the industry itself. Victor, some will say that all of this move towards AI and the response to the proxy advisor industries.

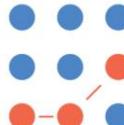
First of all, some would say it might be just a reckoning for proxy advisors. Others are going to say, look, this is exactly the type of disruption AI is going to do in the economy and the market. It's just an industry that's facing it right now.

Then there are others that are going to say, slow down. What's the big deal? Proxy advisors always did sampling, predictive analysis, and AI is just going to make it faster, but maybe with a different bias.

We're going to unpack a lot of this as we go through today's conversation, but let's start off with a bit of a primer. For those who might not be as initiated on this, what can you tell us about what proxy advisors do?

Victor Li (2:49 - 3:12): They have analysts covering all those markets. They understand the governance standards of all countries, and they just get those data, provide analysis and





recommendations to our shareholders. And you can pray whether your shareholder will follow their advice or not.

If they don't, and they may have their own mind, but they subscribe to those services so that they don't have to read your proxy documents.

Rahul Bhardwaj (3:12 - 3:28): Right. As a former corporate lawyer myself, I can remember drafting proxy circulars, and the only ones that really read those are the analysts and the lawyers because they're pretty dense. So a Glass-Lewis or an ISS, they'd be retained by companies to provide them information about what's in the circulars.

Victor Li (3:28 - 3:44)

Before, we only had directors and auditors. Now we have say and pay, and we have a lot of shareholder proposals. Some companies could receive 10 shareholder proposals, and some are new, some are old, and proxy advisors, they have to figure out how to make a recommendation.

Rahul Bhardwaj (3:45 - 4:03): This industry evolved to provide these recommendations. So, the proxy advisors were providing a real service to investors, but not everybody's been a fan of them, including the U.S. president, and in this case, Jamie Dimon as well. What were some of the concerns around the proxy advisory industry?

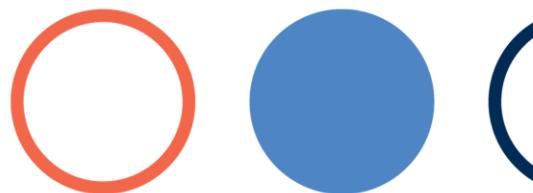
Victor Li (4:03 - 5:32): I can paraphrase Jamie Dimon. He sent a letter to his shareholder at JPMorgan about two years ago saying proxy advisors have done some good in the past by compiling data, but now they have gone too far to incorporate too many ideologies into their recommendations. So that's one of the reasons that JPMorgan, like two years ago, started this.

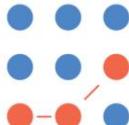
They are totally out of the picture, and the reason to solve these questions around proxy advisors are conflict of interest, not transparent methodology, one size fits all. There's no company-specific context to their analysis recommendations, and proxy advisors facing pressures from all aspects, Congress, president, state, asset managers are also facing pressure. The pressure on asset managers is that why do you rely on others to tell you how to vote your shares?

Why can't you do your own work to fulfill your fiduciary duty to your investors? Before JPMorgan, the big three, BlackRock, Vanguard, State Street, they already cut their recommendations from ISS. They have their in-house policy, in-house people to do those research and recommendations.

They even allow their investors to pick how they vote. We call that voting choice or passing through vote. Other asset managers have taken a different approach.

They still use ISS to a certain extent to gather data, but not driving the recommendation.





Rahul Bhardwaj (5:33 - 6:31): It sounds like the proxy advisor industry has been in flux for quite a while, but this sounds like a very special moment with the introduction of this new technology. And if I've got this right, there are two concerns among several that folks would have in the proxy advisor industry. One would be around transparency, and this is the methodology of how did you come up with your recommendations?

And the other one was around conflict of interest. If we think about what AI is trying to solve here, I think, and correct me if I'm wrong, it's going to try to take the conflict of interest out because they're not going to be providing any additional services back to the investor. So that's a simple one.

Let's talk about the other one around transparency now. We know that in the former world, the proxy advisor would have their own biases and their not necessarily negative ones, but they could be biases in there that are going to be informing recommendations. Am I correct so far?

Victor Li (6:31 - 6:32): Yeah.

Rahul Bhardwaj (6:32 - 6:38): And now AI is notionally going to take those out or are they just going to utilize different biases?

Victor Li (6:38 - 7:42): I mean, that would be the same. There'll be a trend by the same like governance standards or beliefs that whichever investor, for example, JP Morgan. JP Morgan has certain policies that are different from ISS or Glass-Lewis.

When they train their AI, those policies will be reflected. But JP Morgan's policy is not as transparent as ISS or Glass-Lewis because ISS and Glass-Lewis, they offer their service to so many investors. There's market demand for them to be as transparent as possible.

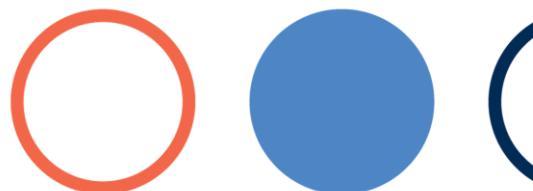
But JP Morgan does not have that pressure yet. I can give you an example. The ISS, their Canadian policy is probably like 60 pages long.

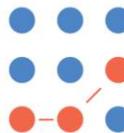
Their US policy is 100 pages long. But JP Morgan's global proxy voting guidelines is only 60 pages. And they combine Canada and the US into a 10-page policy.

You can imagine the transparency will only be reduced unless they got pushed by their investor to be more transparent.

Rahul Bhardwaj (7:42 - 7:56): We're going to start talking a little bit more about what do we need to be thinking about as Canadian directors. Before we get right into the Canadian boardroom though, what are the implications of this decision south of the border on the Canadian capital markets?

Victor Li (7:57 - 8:41): In the short term, we are business as usual because JP Morgan's decisions only impact their proxy voting for US companies. One reason I think is because the US company disclosure is more AI friendly. AI can read the US disclosure better than Canadian





disclosure because we don't have structured disclosure here in Canada.

Directors of Canadian companies, we don't have to worry about this here. But there will be a pressure for Canada or other countries to move to a standard disclosure in the future just because if AI can do that in the US, we'll face that. Companies should be prepared that the disclosure requirement in terms of standards will be changed in the future.

Rahul Bhardwaj (8:42 - 9:01): So, are we actually saying that the fact that we've got no national securities regulator is actually a protector in this case? Isn't that one of the ironies of all of this? But you're saying this is only a short-term thing, that at some point AI will either be able to pick up on those or there's going to be conforming to a more standard form.

Victor Li (9:01 - 9:23): Yeah, I'm hoping that AI will be smarter so they can read our unstructured disclosure so that we don't have to change our behavior. I can see that happening, actually, because before how AI grabbing the data from the disclosure is less sophisticated. Now with the LLM, they can actually read, analyze those data.

Even if the data is not structured, they're able to read that.

Rahul Bhardwaj (9:23 - 9:43): Interesting. Let's bring it into the boardroom now. Directors were used to a certain type of shareholder engagement.

They were used to a certain type of engagement with proxy advisors, some more productive than others, some would say. But now we're in a new environment of AI. How do directors need to shift their thinking?

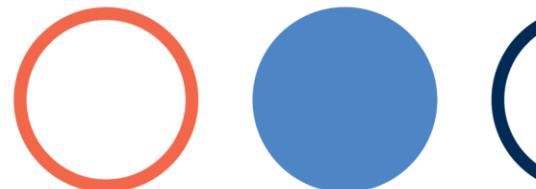
Victor Li (9:43 - 10:56): I mean, they will need to understand whether their investors are using AI to decide their roles, just like JP Morgan. But the good thing on JP Morgan is that JP Morgan hasn't been a big fan in terms of engaging with their investor economists. We haven't actually encountered any board JP Morgan SMM engagement in the past.

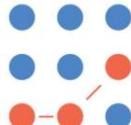
The big three, like BlackRock, State Street, Vanguard, they are all for engagement. CPP here, they are open for engagement. But JP Morgan in the past, I think they treat the proxy voting as just a call center and not as a tool for stewardship of the capital of their clients in trust them.

We haven't engaged JP Morgan in the past, ever. Now, sure, with AI, they can free up resources, so their PMs or their stewardship team will be more open to engage with directors. But for others, as more and more investors are copying this kind of model, using AI to drive decisions or voting recommendations, companies probably need a better advisor that can use another AI tool to gauge how those recommendations come from.

We are still thinking about that, but it's too early to know the impact at this moment, I think.

Rahul Bhardwaj (10:57 - 11:03): Victor, I'm reading you here and I'm thinking to myself, are we right around the corner from a day where a company has got a chatbot?





Victor Li (11:03 - 11:04): Yeah.

Rahul Bhardwaj (11:04 - 11:49): Its own AI chatbot that's going to be talking to the JP Morgan AI chatbot on these issues? For the last couple of years, the notion of stakeholder engagement has been so front and center for boards of directors to understand it on so many levels, whether it be geopolitical. Obviously, there was a whole time when ESG, indigenous, all the shareholder proposals were coming forward and directors were really focused on making sure they understand the needs of the shareholders and stakeholders so they can balance that.

There's a lot of effort put into having a management team that was sensitized to this, not only from a reputational standpoint, but from a growth standpoint. Is this going to force directors to be looking at a different source of data altogether?

Victor Li (11:49 - 12:43): I mean, AI can help them to analyze those data. I think with this, particularly in the ESG space, the AI can do those analysis across work, across market easily. I think with AI, many things that in the past not happening, I think it's easier and that you can just keep prompting AI asking for questions.

It's so easy. If you do a homework, you can ask better questions or AI can help you to ask questions. Before I came here, I even asked AI to develop a proxy voting guidelines for JP Morgan.

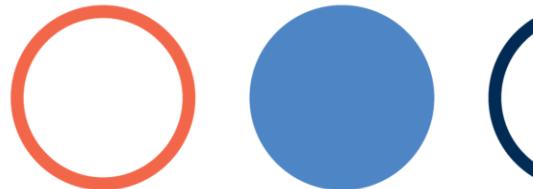
And based on their current proxy voting guideline, which is a little bit outdated, they issued that April last year. Talking about transparency, if you only issue a proxy voting guidelines in April, companies have already prepared their proxies. So it's kind of late.

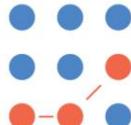
But with AI, AI can make the policy updates faster. AI can be more interactive than a human being because they don't sleep.

Rahul Bhardwaj (12:44 - 13:18): If I'm serving on a Canadian public company board, and I know that this is going to be the future, we've got a lot of very experienced directors serving on the boards. But AI is something that's so new that no matter how much work you've done over the last couple of years to get used to it, none of us are digital natives in that space entirely. Would you be advising these directors to be talking to their management teams and perhaps their investor relations professionals to start helping them understand how to interact better and engage more through AI?

Victor Li (13:19 - 14:19): Yes, I think they also should ask around the table to see which directors can be replaced by AI if they are now contributing to the board discussion. That would be an interesting question on the board evaluation. And they should make sure their management team are giving them regular updates on the opportunity and risk of AI being brought to the organization regularly.

Because AI poses both opportunity and risk. When there's new technology, it's always two sides. And I think this year or in the next couple of years, we all heard from Elon Musk that doctors could be replaced in three years, right?





You don't have to go to medical school. And directors, and almost I feel like the more I use AI, the more I feel like we're training AI to replace ourselves. Do we have to work that hard to train them?

Or we'll give something to ourselves. And directors, the same thing. Whether your colleagues should be, I'm thinking a board of, as we discussed, I'm thinking a board of three should be enough.

Why three? They can vote to decide whether to take the advice from the AI.

Rahul Bhardwaj (14:19 - 14:48): A board of three, that might be seen as a knock-on effect of AI. We started today's conversation talking about how AI has disrupted proxy advisors. And now we're talking about the knock-on effect of that might be the reduction of size of boards.

And that's been a trend for a while. We've been looking at boards and they're getting smaller and smaller. But how small is too small?

Three is an interesting stake in the sand to put there. Do you think that that's realistic?

Victor Li (14:49 - 14:55): I mean, I like our number three or five, right? I can't go to five, but I think three is the minimum you need to have. One is just two.

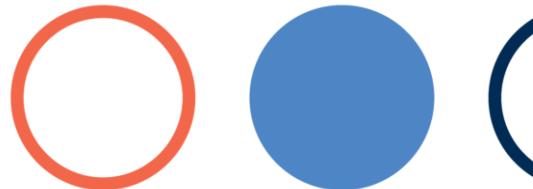
Rahul Bhardwaj (14:56 - 15:25): Maybe we'll revisit that one day and we'll see what the optimum number of directors would be. I think there are a lot of directors who will be looking at this development very closely and saying that there could be some extraordinary efficiencies in this as well. And you're right, the type of questions and engagement they're looking for, they may actually get those answers much more quickly.

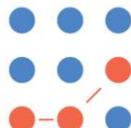
It's going to be very interesting to see how that plays out, particularly across different industries. Because I'm not sure that it's going to have the same impact on each industry either. Do you have a point of view on that?

Victor Li (15:25 - 15:43): I mean, all the industry can now be, it's like when we talk about proxy contacts of companies, which companies are less vulnerable. But after those big companies got contested by the shareholders, we see nobody's immune to proxy contacts. And for sectors, I think no sector is immune to the challenge of the AI.

Rahul Bhardwaj (15:44 - 16:04): If I go back to the JP Morgan's situation right now, you talked about transparency, you talked about methodology, potentially biases underlying these recommendations. Has there been any talk about how boards can understand the methodologies that are going to support the recommendations that are coming at them?

Victor Li (16:05 - 18:23): I mean, understanding the methodology, I had to study a long time to understand one shareholder's policy. The board, I think they are at a high level. They only need to, sometimes they only need to advocate information.





There's common rules on corporate governance. No matter if it's a human being doing the vote or AI doing the vote, there's some common factors. So that's why in the past, proxy advisors have this benchmark policy.

The benchmark may be moving, but we may have a new benchmark. But there's always a commonly accepted standard. The board, you have to do good.

You have to have a board with diverse knowledge, experience, and you have to deliver performance and you have to avoid conflict of interest. There's many standards. I asked AI to compare the JP Morgan policy and the ISS policy, the differences.

Now they come out some differences, also come out with some very similar views. For example, a director, you have to attend more than 75% of the board and you cannot sit on too many boards. That number may be different, but the idea is the same.

And the board has to be majority independent or two-thirds independent. Some things are case by case. Whether that information is mature to the company, a shareholder proposal, ESG, or other type of proposal to either to limit shareholder rights or give too much shareholder rights.

There's always a balance up there. I think JP Morgan's policy, based on my understanding, is that they are pro shareholder rights, but they don't want to get into too much width into the operation of the company, which is a balance. But their policy is less aggressive than ISS benchmark policy.

The benchmark policy is more stringent. And maybe because of the AI thing, the benchmark will be lower. So that will be more pro-management.

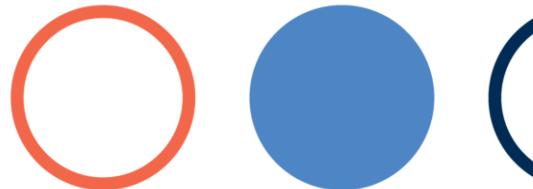
The simple AI model I can think about, if your philosophy is I invest in this company, I will always vote for the company. Then my AI model is very simple. Always vote for.

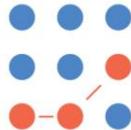
You start from there, you can say, okay, there's maybe something I don't like. The investor may be different. You maybe add two more things or you want to subtract two more things.

There may be like a hundred different versions of those proxy voting policies, but to get the majority support, you need to stick closer to the middle or to the benchmark. This is the same to the political environment. If you are going to the extreme, it won't be the majority.

Rahul Bhardwaj (18:23 - 19:13): Just on that note, there is an inference in this whole environment of JP Morgan moving in there that by moving towards AI, that they'll be taking out some certain ideological components to this. Is that just another way of saying that they're going to filter out to a different bias? I think it will be more pro-management.

Interesting. That's a great place to leave it today. You know, we've taken quite the tour on this and I guess this is only the first inning of many innings game here.





So, we'll see that. Victor, thank you so much for joining me today. I think today's was extraordinary conversation.

It's still evolving in the news as we speak. And I'm going to say to our listeners right now, which way would you vote? The resolution is Be It Resolved: Proxy advisors are another victim of AI. Victor, which way would you vote?

Victor Li (19:13 - 19:41): I actually will vote against because I think the proxy advisors, they see this more as opportunity. They can develop their own AI tool. They can sell their AI tools to other investors.

And I think they may be able in the position to develop a better AI tool than JP Morgan's in-house tool because their experience globally. And the victim may be their employees but not proxy advisory firms at the firm.

Rahul Bhardwaj (19:42 - 20:07): Interesting. So not a victim, but a beneficiary potentially. Potentially.

Well, thank you all for listening to this episode of Be It Resolved. We hope the discussion provided practical insights into emerging governance considerations shaping today's boardroom. For more conversations on governance and board leadership, we invite you to subscribe to your preferred podcast platform from the Institute of Corporate Directors in Canada.

I'm Rahul Bhardwaj. Until next time.

