

# VoterMedia.org

---

Mark Latham, Founder • mark@votermedia.org • Tel (604) 806-0652

September 21, 2012

Investor Advisory Committee  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Suggestions for IAC agendas

Dear IAC members:

Thank you for taking up the challenges of advising the SEC. As a member of the previous SEC IAC, I especially appreciate your willingness to contribute your time and expertise to this important task. As you plan the agendas for the IAC and its subcommittees, I would like to offer some ideas on policy issues that may be worth prioritizing.

On the previous IAC, I represented "individual investors, particularly with respect to their role in corporate governance" [as per my appointment letter from Chairman Schapiro]. I mainly contributed ideas relating to the proxy voting system, especially the role of proxy advisory firms, and how to increase the quality and quantity of voting by retail investors and institutional investors. I summarized most of those ideas in my comment letter on the SEC's proxy voting concept release, which is online at [www.sec.gov/comments/s7-14-10/s71410-52.pdf](http://www.sec.gov/comments/s7-14-10/s71410-52.pdf) (also appended below).

Please consider taking up the issues and ideas in that comment letter. It would be especially relevant for your "Investor as Owner" subcommittee, and has some relevance for your "Retail Investor Issues" and "Financial Literacy" subcommittees.

An updated version of some of the ideas on proxy advisory firms are in a recent shareowner proposal submitted to Costco, so I would suggest looking at that too. It's online at [votermedia.org/proposals/20120824-COST-ProxyAdvisor.pdf](http://votermedia.org/proposals/20120824-COST-ProxyAdvisor.pdf).

Feel free to contact me regarding any of this, by email or phone.

Sincerely,



Mark Latham

September 29, 2010

Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: SEC Concept Release on the U.S. Proxy System; File Number S7-14-10

Dear Ms. Murphy:

I have been representing individual investors on the SEC Investor Advisory Committee from July 2009 through September 2010. These comments are my own personal views, and do not necessarily reflect the views of the Committee. My views are intended to reflect the broad public interest, and thus the interests of us retail investors. For background on me, my résumé is on the web at [votermedia.org/mlresume](http://votermedia.org/mlresume).

We retail investors are the principals in the principal-agent system of corporate governance. We are the beneficial owners of all equities – in the U.S., 25 to 30 percent via direct purchases, and 70 to 75 percent via our ownership of shares in mutual funds, pension funds and other intermediaries. (By "share" of a pension fund, I mean the fraction of the fund's assets that funds a person's expected future benefits.) The agents in our corporate governance system include CEOs, boards of directors, institutional investors, proxy advisory firms and regulators.

Most of these agents are hard-working skilled professionals, providing us with valuable services that usually enhance our investment returns, so we are happy to pay for their services. However, as in any principal-agent system, the interests of agents are likely to diverge from the interests of principals on certain issues. The most obvious divergence is on pay. Agents prefer to be paid more, while principals prefer to pay "enough" but not more than some optimum level (hard to determine). Especially when agents are being overpaid, they prefer to keep their agency positions, even if they are not the best people for the job. So principals naturally benefit from more competition among agents. Principals also benefit from disclosure of information that permits a critical evaluation of the agents' performance.

What economists call "agency costs" are not the payments made to agents for their services. Agency costs are the net losses to society (i.e. to the economy) caused by the divergence of agents' interests from principals' interests. These include the inefficiencies from:

- efforts by agents to enhance their own pay other than by adding value to corporations (e.g. by making the market for their services less competitive);
- actions by agents to enhance their own pay while harming the value of corporations (e.g. hiding poor performance, not admitting mistakes);
- not having the most suitable people in the agency positions;
- costs of monitoring agents' performance.

An effective corporate governance system tries to minimize these agency costs. Our recent financial crisis is clear evidence that we are still far from achieving this objective. Thus policy reforms should emphasize increasing competition among agents, and empowering principals with better information systems to evaluate agents' performance.

One reason why reform is difficult and slow is that agents tend to be concentrated and organized, while we principals are more diffuse and less organized. Some agents also control and use the principals' funds. As a result, lobbying by agents is louder and better funded than lobbying by principals.

Proxy voting is a crucial component of our corporate governance system. It is the primary means of holding corporate management and boards accountable to investors. I believe there are several key improvements to our proxy voting system that we could implement, which would substantially improve accountability, reduce agency costs, help prevent future financial crises, and strengthen our economy. In my comments below, I will try to outline these potential improvements in priority order, and suggest how the SEC could help make them happen.

## **1. Client Directed Voting [Release section IV.B-2(c)]**

The SEC should encourage and support the development of Client Directed Voting (CDV), also called Advance Voting Instructions, for retail investors.

I have written about CDV extensively elsewhere, so will keep these comments brief and focused. For more detail please see these papers, available at [votermedia.org/publications](http://votermedia.org/publications):

- Client Directed Voting Q&A
- Proxy Voting Brand Competition
- The Internet Will Drive Corporate Monitoring

There are many possible designs for CDV. To maximize the benefit to our economy, CDV should be open and free:

Open –

Any individual or organization can publish on the internet their opinions on any voting items at any corporations. These may include institutional investors, retail investors, bloggers, activists and proxy voting advisors, as well as the issuers' boards. Standardized electronic formats (like those of blogs) facilitate sharing and remixing of published opinions, to create a wide variety of "voting feeds" – sources of real-time opinions covering a wide range of corporations. Each retail investor can choose any public voting feed as a source of voting decisions, and give advance instructions to vote our shares in accordance with that feed. These advance instructions may include all shares we own (including future purchases) and all voting matters. We can change our choice of feed at any time, and override individual voting decisions manually if we desire. Annual reaffirmation of our instructions would be a reasonable requirement.

Free –

For the same reasons as in our democracies, voters should not have to pay to vote. Voting creates collective benefits for all shareowners of a corporation, so the infrastructure costs of voting should be paid by all shareowners as a group, i.e. with corporate funds.

For the sake of brevity, I will use the term "Open CDV" to mean a system with both the above features, open and free.

Quality of voting is more important than quantity of voting (voter turnout). Open CDV would increase both the quality and the quantity of voting by us retail investors. It is the retail analog of the specialized team approach used by institutional investors in their proxy voting decisions. Fund managers don't read all the proxies of all the stocks they hold and decide how to vote each issue. They have professional staff for that, some in-house, some out-sourced. And of course, we beneficial owners of those stocks – e.g. retail investors in mutual funds – don't read and make voting decisions on all those proxies either.

Likewise it would be inefficient for every retail investor to read all the proxies of every stock we own directly. Instead, we can specialize too. Some of us can read proxies and share our insights on how to vote. We can also get insights from some institutional investors who choose to share their voting decisions before the deadline. We can discuss the voting records of those institutions, and share insights on which are worth emulating. Thus information sharing and competition among experts would give the broad public benefit of more intelligent voting.

However, I think the most significant impact of Open CDV will be to increase the quality of voting by *institutional* investors. This will happen because of implicit competition among various voting opinion sources, and their evolving reputations in the eyes of retail investors. Even institutional investors who do not share their voting decisions before the voting deadline will be compared with other opinion sources, after their votes get disclosed later in the year. Once Open CDV has facilitated intelligent voting by many of us retail investors, we will compare our voting styles with those of institutional investors who are voting the stock we own through them. The website [ProxyDemocracy.org](http://ProxyDemocracy.org) is already giving us a preview of how institutional investor voting performance can be compared – see for example [proxydemocracy.org/fund\\_owners/focus\\_lists/25](http://proxydemocracy.org/fund_owners/focus_lists/25) on climate change resolutions.

Here are some ways the SEC could encourage and support the development of Open CDV:

- (a) Recognizing that much of the infrastructure for CDV can be built voluntarily by the private sector, SEC commissioners could informally advocate Open CDV in speeches.
- (b) Mandate standardized tag-data formatting for N-PX filings of mutual fund votes. The SEC Investor Advisory Committee advocated this in its [Resolution on Proxy Voting Transparency](#), passed unanimously at the 2010-02-22 IAC meeting. It would make mutual fund vote data widely accessible in organized formats at low cost, facilitating critical evaluations of these agents' performance. The same standardized tag-data format could then also be used for sharing anyone's voting opinions in real-time Open CDV systems.

To maintain consistent tagging for all votes on a given proxy, ideally the voting items should be tagged by the issuer in the proxy filing. For CDV purposes, it is not necessary to tag all data in the proxy (although that may eventually be worth doing also). As a half-way alternative to tagging, issuers could be required to have a clear unique human-readable label for each voting item in the proxy (e.g. "1a", "1b", "3", "4"), and the N-PX could be required to use those. (This is not the case currently, as often director elections have a single number and then a list of names, leading to diversity in how N-PX filings number the items.)

- (c) Clarify and relax proxy solicitation rules that could be exerting a chilling effect on open exchange of proxy voting opinions. Filing requirements impose a cost on speech, making it no longer free. Participants seeking to influence votes for their private gain will be willing to pay the cost of filing. Many participants who would have been willing to share their opinions for the public benefit without private gain, may be unwilling to pay the cost of filing. So filing requirements tend to silence speech that would benefit the public, leaving us with only the speech that undermines the public interest. This kind of logic must be part of the wisdom underlying the first amendment to the U.S. constitution.

An example of these problems with proxy solicitation rules is Rule 14a-2(b)(6), which exempts solicitations from filing requirements if they are made in an electronic forum more than 60 days before the AGM. This helps little, because the last 60 days before the AGM are the most important period, especially for electronic forums (and CDV systems) since they can respond in real time to proxy filings leading up to the AGM. This rule implies by omission that filing rules are stricter in the last 60 days, but those stricter rules are in turn too strict and unclear.

The website [MoxyVote.com](http://MoxyVote.com) is the closest thing to retail CDV that we have so far, but participation there by voting opinion leaders is being chilled by this strictness and lack of clarity. It should be made clear that those publishing opinions and influencing votes, but that have less than 5% share ownership and no direct control over votes other than their own, are exempt from the filing and

notification requirements of the proxy solicitation rules. Any 60-day blackout period should be removed or should not apply to communication by these exempt parties.

Another recommendation for relaxing proxy solicitation rules: If a broker offers CDV functionality to its retail clients, that should not be considered a proxy solicitation.

- (d) Adapt the existing issuer-paid fee system for proxy distribution and vote collection to pay for some or all of the infrastructure for CDV, especially to eliminate fees for submitting votes electronically. Thus all shareowners would be paying for this collective benefit.
- (e) Require retail brokers to forward each client's proxy ballots to any electronic platform chosen by the client. This will encourage competition among voting platforms, leading to more attractive user interfaces and greater retail voter participation.
- (f) Monitor the development of CDV systems to ensure that retail investor voting decisions are kept confidential. This is in contrast to policies regarding institutional investor voting decisions, where vote disclosure is desirable for the sake of accountability to beneficial owners.

Disclosure of voting decisions opens the door to vote-selling, whether by individuals or by institutions, which can easily occur via implicit behavior patterns and business relationships (much like political campaign contributions). One of the great advantages of CDV for retail investors is that it enables professionally informed voting without disclosure of the actual voting decisions.

Therefore disclosure of unaggregated retail votes should be prohibited. Even those retail investors who want to *say* how they voted (that's OK), should not be able to *prove* how they voted. This is consistent with the standard practice of confidential voting in our democracies, and for the same reason – to prevent vote-selling. Partly for this reason, and partly because of competition among voting advice sources, we can expect retail voting through CDV to give higher quality decisions on average than institutional voting.

- (g) To ensure that we retail investors have access to competing sources of proxy voting advice loyal to us, push for competitive funding as explained in section 2 below. This can also help fund infrastructure needed for Open CDV, such as defining a taxonomy for vote data, tagging voting items in proxies, and creating software and websites for sharing voting opinions.

## **2. Competitive Funding for Retail Proxy Voting Advice [Release sections IV.B, IV.C and V.A]**

Most of us retail investors don't find it cost-effective to pay for professional proxy voting advice individually. Free sources of voting advice are available, but to maintain and enhance quality, it would make sense to pay for some professional advice also. It should be funded collectively with funds allocated competitively. Once we have paid for it collectively, this voting advice can and should be shared freely.

Possible funding sources include securities litigation settlements, federal government agency budgets (such as the SEC or the Consumer Financial Protection Agency), and fees from corporations. Similar to the reasoning for proxy distribution fees, since we retail investors are the beneficial owners of all corporate stock, it makes sense for us to use our corporate funds for voting advice that benefits all shareowners.

Competition among proxy advisors is important to ensure that we get value for money. Letting us retail investors allocate collective funds by vote to competing advisors would also ensure loyalty to our interests. I founded the nonprofit project [VoterMedia.org](http://VoterMedia.org) to develop and test such a voter funded allocation system. Our tests have proven successful, so we are now offering our platform to voter communities at no charge. Each community typically pays its competing advisors (information providers) directly, so no funds need flow to or through [VoterMedia.org](http://VoterMedia.org). Our website just provides the voting platform, tallies votes, and calculates awards.

As part of an initiative to create a CDV system, the SEC could recommend that a pilot program be launched to pay for retail proxy voting advice. This competitive voting system is efficient enough that even as little

as \$1 million per year could produce substantial public benefit by improving the quality of retail investor voting. This could buy some original proxy research, help a few websites gather various available sources of advice, and build a quality reputation system.

Such a program could also support other shared benefits for retail investors, including:

- infrastructure needed for CDV, e.g. tagging of voting items in the proxy;
- investor education.

Further information is available at [votermedia.org](http://votermedia.org), including a sample ballot page [votermedia.org/usainvestors](http://votermedia.org/usainvestors).

### **3. Proxy advisory firms [Release section V.A]**

Most or all of the concerns cited can best be addressed by making the market for proxy advice more competitive. This is difficult to achieve, because the benefit of good voting based on good advice is shared by all shareowners of the corporation. As a result, each investor participant has little incentive to pay on its own for better advice. Even institutional investors suffer from this lack of incentive, since a typical institutional holding is less than 1% of a company's shares.

The solution is to create a competitive market for shared benefits, like the system proposed in my comment section 2 above. There I proposed a national market for advising retail investors on all corporate voting, but it can also be organized for one corporation at a time. All shareowners of a corporation would vote to allocate, for example, \$50,000 of their corporation's funds per year among several competing proxy advisors. Advice paid for in this way would then be published for all shareowners to use freely.

Shareowners can use their voting power to push their corporate directors and managers to implement such a system, so it may not need SEC involvement to get it started, once investors learn the benefits. But a national pilot program for advising retail investors could set an example that would demonstrate those benefits. And a CDV system would increase the overall quality of investor voting, which would increase voting support for implementing this competitive market at each corporation.

Thus my comment sections #1 and #2 above are also my advice for solving problems relating to proxy advisory firms.

### **4. The proxy communications system should be kept outside corporate management's control [Release sections III.D and IV.A]**

The corporate governance playing field is inherently sloped in favor of entrenched management, so regulatory policies should counteract that. Management is the primary example of concentrated agents who often pursue their interests at the expense of diffuse principals, as discussed above. The public interest is best served by empowering principals so as to minimize agency costs, a major cause of weakness in our economy.

Especially in the proxy process, management regularly uses shareowners' funds (corporate funds beneficially owned by shareowners) to hire lawyers to oppose shareowners and further entrench management power. Efforts to make boards independent of management have so far not been very effective. The term "independent director" is largely a legal fiction – independence in name but not in behavior. Calling some directors independent doesn't make them independent. So when I refer to "management", I typically mean "management and directors" since they usually work as a team.

My advice on specific issues:

- (a) OBO<sup>1</sup> should be the default status for all retail investors. NOBO should be by opt-in only. A NOBO default would increase the entrenchment of corporate management. An OBO default would better protect retail investors' privacy. Issuers should not be able to solicit proxies directly from beneficial owners.

To go in the opposite direction by eliminating OBO status would subject retail investors to more self-serving communications from management than is allowed in the current system. Management would spend shareowners' funds to pay communications staff for this purpose. Thus it would be like letting incumbent politicians use public tax funds to finance their reelection campaigns.

Instead, management should communicate with shareowners via the public forums created by Open CDV and competitive markets for public advice proposed in my comment sections #1 and #2 above. There, opinion leaders will balance management's views with other views more loyal to shareowners' interests, resulting in overall higher quality information for retail shareowners.

For the past four years, VoterMedia.org has been developing and testing a voter information system like that proposed in comment section #2, at the University of British Columbia's student union. As an experienced participant described it: "...having those eyes going towards a student voice that's well informed, has been instrumental, not only as a tool for student governments to get their message across, but also as a tool for the student body to get their message across to the student governments." See [votermedia.org/videos/1](http://votermedia.org/videos/1).

- (b) If you consider changing the system of paying for distribution of proxies, do not let management control the choice of service provider. Here again, there are likely to be too many opportunities for management to tilt the system further away from the principals' interests.

If it is important to increase competition in the proxy service business, that could be safely achieved by letting the company choose the service provider, as long as it is we, the *company of shareowners*, choosing by vote among competing providers. Each provider could bid a price for this service, we shareowners could vote in the proxy to choose the service provider for the following year, and pay the chosen provider's bid price using our company funds.

- (c) The development of Open CDV and competitive funding for retail proxy voting advice will counteract the harm from management influence over proxy communications. When we retail shareowners have a better information system loyal to us, we will be less vulnerable to management propaganda. So my comment sections #1 and #2 above, if implemented, will help solve the problems discussed in this section also.

---

Thank you for undertaking this important review of the proxy system and inviting comments. Please feel free to contact me with any questions. Best wishes for success in improving how it all works!

Sincerely,



Mark Latham

Founder, VoterMedia.org

---

<sup>1</sup> OBO = Objecting Beneficial Owners = shareowners who do not let their brokers give their contact information to the management of corporations they own shares in. NOBO = Non-Objecting Beneficial Owners = shareowners who let their brokers give their contact information to the management of corporations they own shares in.

## **Proxy Advisor Competition Proposal**

I am pleased to be working with James McRitchie and Myra Young again on a shareowner proposal for improving corporate governance. In 1999 we drafted, and Jim submitted, the first in a series of proposals for shareowners to vote corporate funds to pay competing proxy advisors. We have recently drafted the latest in this series, and submitted it to Costco. Compared to our earlier proposals, this new version would support four advisors instead of just one; it would take two years to implement instead of three years; and shareowners would vote *after* seeing the proxy advice instead of before. These changes are based on successful test implementations at the University of British Columbia -- see "Experiments in Voter Funded Media" at [votermedia.org/publications](http://votermedia.org/publications).

Here is our latest revised (2012-08-24) proposal draft:

### **PROXY ADVISOR COMPETITION**

WHEREAS many shareowners lack the time and expertise to make the best voting decisions, yet prefer not to always follow directors' recommendations;

WHEREAS shareowners could benefit from greater competition in the market for professional proxy voting advice;

THEREFORE BE IT RESOLVED that Costco (Wholesale Corporation) shareowners request the Board of Directors, consistent with their fiduciary duties and state law, to hold a competition for giving public advice on the voting items in the proxy filing for the Costco 2014 annual shareowners meeting, with the following features:

- The competition would be announced and open for entries no later than six months after the Costco 2013 annual shareowners meeting. To insulate advisor selection from influence by Costco's management, any person or organization could enter by paying an entry fee of \$2,000, and providing their name and website address. Each entry would be announced publicly, promptly after it is received. Entries' names and website addresses (linked) would be shown promptly on a publicly accessible Costco website page, in chronological order of entry. Entry deadline would be a reasonably brief time before Costco begins to print and send its 2014 proxy materials.
- The competition would offer a first prize of \$20,000, a second prize of \$15,000, a third prize of \$10,000, and a fourth prize of \$5,000.
- Winners would be determined by shareowner vote on the Costco 2014 proxy. The Costco Board would include this voting item in that proxy: "Which of the following proxy advisors do you think deserve cash awards for how they have been informing Costco shareowners? (You may vote for as many advisors as you like. See each advisor's website for their information for Costco shareowners.)" Then the name and website address of each advisor entered would be listed in chronological order of entry, with a check-box next to each. The advisor receiving the most votes would get first prize, and so on.
- It would be expected that each proxy advisor would publish advice on its website regarding the Costco 2014 proxy, but there would be no formal requirement to do so. The incentive to win shareowner voting support and to maintain the advisor's reputation would be considered sufficient motivation for giving quality advice.
- The Costco filing that reports the final 2014 proxy voting results would show the total number of shares voted for each proxy advisor.

- The decision of whether to hold such a competition in subsequent years would be left open.

(Further information on proxy advisor competitions: "Proxy Voting Brand Competition," *Journal of Investment Management*, First Quarter 2007; free download at <http://votermedia.org/publications>.)

=====

The idea is that we shareowners can use our voting power to hold boards accountable more effectively if we have high quality professional voting advice. Although many institutional investors pay for proxy advice from the two major U.S. advisors, ISS and Glass Lewis, there is not enough economic incentive to pay for more than a minimal amount of proxy research, as explained on page 82 of "Proxy Voting Brand Competition". The result: complaints about lack of insight, and insufficient competition.

From the March 2011 Altman Group Report on Proxy Advisory Firms:

"... one of the primary complaints from corporate issuers is that proxy advisory firms rely heavily on a 'cookie cutter' or 'one-size-fits-all' approach, and may base recommendations on inaccurate and unreliable information in particular cases." [page 9]

"The investment manager for one of the world's largest sovereign wealth funds indicated that it would like to see measures taken to promote competition among proxy advisory firms." [page 31]

The above Proxy Advisor Competition Proposal would increase competition among proxy advisors, and pay them enough to provide higher quality advice, tailored to the specific corporation. The proposal organizes a corporation's shareowners as a group, pays for proxy advice once, and shares the advice with the whole group. This "advice consumers' union" approach may well get better analysis for lower cost than the current system of paying for advice one (institutional) investor at a time. It would also make the advice available to *all* Costco shareowners, including retail investors who typically do not get professional voting advice now. This proposal is designed as a template to improve the governance of any publicly traded corporation.

We welcome your comments. How can we improve this proposal? If it is implemented, what results would you expect?

-- Mark Latham; 2012-08-24