November 9, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number 4-725

Dear Mr. Fields:

These comments are submitted on behalf of Business Roundtable, an association of chief executive officers who collectively lead companies with more than $7 trillion in annual revenues and nearly 15 million employees. Member companies annually pay nearly $296 billion in dividends to shareholders and generate more than $488 billion in revenues for small- and medium-sized businesses. In addition, Business Roundtable members invest over $147 billion annually in research and development.

Business Roundtable appreciates the opportunity to provide input for the Securities and Exchange Commission's (the "Commission" or "SEC") upcoming Roundtable on the Proxy Process (the "Roundtable"). Business Roundtable supports the Commission's efforts to evaluate and improve the proxy system, and agrees that as a result of regulatory, technological and market changes, the time is right to discuss and propose updates to the current proxy system.

Business Roundtable believes that having an accurate, efficient, transparent, and verifiable proxy system that is oriented toward long-term value creation is vital to constructive shareholder engagement and the successful operation of public companies. The importance of this point was made clear in the SEC's 2010 Concept Release on the U.S. Proxy System (the "2010 Concept Release"), which noted: "With 600 billion shares voted every year at more than 13,000 shareholder meetings, shareholders should be served by a well-functioning proxy system that promotes efficient and accurate voting."[1]

To maximize the operation of the proxy system, it is critical to address issues and inefficiencies as they are identified. To that end, as more fully detailed in our comment letter, we believe updates and reforms to the proxy system are currently warranted and specifically propose the following:

- Modernizing the shareholder proposal process so that it provides for more effective shareholder communication and engagement and is oriented toward creating long-term value for all shareholders;

[1] SEC Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42982, at 42983 (July 22, 2010).

- Reforming the regulation of proxy advisory firms to improve accuracy, transparency and accountability;

- Reforming and streamlining the shareholder communications and proxy voting process to make voting more transparent and verifiable and to increase retail investor participation; and

- Reforming the disclosure rules under Securities Exchange Act Section 13(d) to ensure timely and transparent disclosures from investors seeking to control a company.

In addition, Business Roundtable believes that the Commission should fully analyze the potential negative implications of universal proxy cards before adopting rules mandating their use.

Business Roundtable believes these updates and reforms will help create a better proxy system that will not only promote more successful shareholder engagement but also benefit investors and other stakeholders over the long term.

Current Proxy System and the Need for Change

The proxy voting system was developed to provide dispersed shareholders a method to vote on proposals in an informed manner without having to attend a company's annual meeting. To that end, when companies solicit votes from shareholders, the Commission requires them to provide shareholders with a proxy statement that discloses information that would be material to an investor's voting decision, including information regarding potential conflicts of interest, and prohibits companies from making false and misleading statements.[2] In theory, this is an efficient and effective way for companies to communicate with their shareholders and for shareholders to receive relevant and accurate information on which to base their votes.

However, many aspects of the proxy solicitation process have changed during the more than 80 years the Commission has regulated it, and the cumulative effects of these changes have resulted in a system in need of modernization and reform.

As an initial matter, communicating with and soliciting votes from the majority of a company's shareholders is more cumbersome than necessary and it is difficult (if not impossible) to verify the accuracy of votes. Public company shares in the United States are predominantly held in "street name," meaning a bank or broker holds the shares on behalf of its client, who is the "beneficial owner."[3] In order to communicate with or solicit votes from a street name holder, companies must navigate a multi-layer system of intermediaries and third-party advisors who

[2] SEC Rule 14a-3, 17 C.F.R. §240.14a-3 (2018); SEC Rule 14a-9, 17 C.F.R. §240.14a-9 (2018).

[3] *Examining the Market Power and Impact of Proxy Advisory Firms*, 113th Cong. 524 (June 5, 2013) (statement of Niels Holch) (noting that reports have estimated between 75 percent and 80 percent of all public company shares are held in street name).

are not uniformly regulated by the Commission. The barriers between companies and retail investors may help explain why only a fraction of retail investors exercise their voting rights. In 2018, retail investors have voted only 28 percent of their shares, while institutional investors have voted 91 percent of their shares.[4]

In addition, concerns exist about how voting decisions are being made. Ownership and voting of public company stock in the United States is dominated by institutional investors: 70 percent of public company shares are owned by institutional investors such as index funds, mutual funds, pension funds and hedge funds.[5] Certain of these institutional investors rely on the recommendations of proxy advisory firms.[6] Concerns have consistently been raised regarding, among other things, the accuracy, transparency, accountability and conflicts of interest related to the recommendations of proxy advisory firms.[7] Based on current practices, serious questions exist as to whether some institutional investors are actually making informed voting decisions based on accurate and material information.

Finally, proxy voting has become more important. Investor activism has not slowed. In the first half of 2018, shareholder activism reached record levels in terms of campaigns mounted and capital deployed, and 2017 played host to 4 of the 10 most expensive proxy contests in history.[8,9] Regulatory changes such as the limitations on discretionary broker voting and required "say on pay" votes, and corporate governance changes such as the trend toward majority voting in director elections, have also heightened the need for a better proxy system and increased retail investor participation.

The rules governing the proxy system have not kept up to accommodate the new realities of the system and do not reflect the current market or technology. Updates and reforms are needed to ensure that the proxy system is working efficiently and effectively to serve the long-term interests of shareholders. The following provides an overview of the issues and the related recommendations for reform that Business Roundtable believes are most critical when evaluating and refining the proxy system and the rules and regulations that govern it.

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[4] Broadridge Investor Communication Solutions, Inc. and PricewaterhouseCoopers LLP (October 2018). *Proxy Pulse: 2018 Proxy Season Review*. Retrieved from https://www.broadridge.com/report/2018-proxy-season-review?id=00203PPRUSA15JUNLPG02PPR&so=se&po=&di=&ct=&ot=rp&mt=oc&yr=18&rg=us&on=01&ep=pd&gclid =EAIaIQobChMIzar1rcmV3gIVF7bICh1D1QYoEAAYASAAEgKYO_D_BwE

[5] Ibid.

[6] Gallagher, D.M. (August 2014). Outsized Power & Influence: The Role of Proxy Advisers. *Washington Legal Foundation Critical Legal Issues Working Paper Series*. Retrieved from https://s3.us-east-2.amazonaws.com/washlegal-uploads/upload/legalstudies/workingpaper/GallagherWP8-14.pdf

[7] Ibid.

[8] Lazard (July 2018). *Review of Shareholder Activism – 1H 2018*. Retrieved from https://www.lazard.com/media/450655/lazards-review-of-shareholder-activism-1h-2018.pdf

[9] Racanelli, V.J. (July 6, 2018). Proxy Voting is Broken and Needs to Change. *Barron's*. Retrieved from https://www.barrons.com/articles/proxy-voting-is-broken-and-needs-to-change-1530924318

Modernizing the Shareholder Proposal Process

Business Roundtable believes effective communication with shareholders is a critical element of the operation of today's public company. The importance of this relationship necessitates a shareholder proposal process that is productive, focused on materiality, and oriented toward long-term value creation for all shareholders. That is not the case today.

Business Roundtable believes the shareholder proposal process is no longer functioning efficiently and needs modernization for two primary reasons: (i) the threshold for submitting a proposal is too low and (ii) excluding proposals relating to general social issues is difficult for companies.

The shareholder proposal process has become dominated by a limited number of individuals who own only nominal stakes (or, in the case of proponents who submit via proxy, no stake) in the companies they target and file similar proposals across a wide range of companies. In fact, from 2016 to 2018, the same three individuals and their families have submitted or co-filed over 24 percent of all shareholder proposals each year at Russell 3000 companies.[10] Among other top shareholder proponents are institutional investors with an express social, religious or policy purpose who may pursue idiosyncratic interests, which may have no rational relationship to the creation of long-term shareholder value and may conflict with what a typical investor views as material to making an investment or voting decision.[11]

In addition, spurred by court-driven changes in SEC policy beginning in the 1970s, companies have had to contend with a continuous influx of proposals focused on general societal issues. Currently, more environmental, social and policy-related shareholder proposals are submitted than any other type of proposal each year.[12,13] These proposals typically have limited success and very seldom receive the majority support of shareholders. In fact, in 2018, only 10 of 145 of such proposals voted on received majority shareholder support.[14]

The current shareholder proposal process also imposes unnecessary costs on companies, both in money spent to exclude inappropriate and immaterial proposals and in the loss of board and

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[10] ISS Corporate Solutions, Inc. (2018). Voting Analytics – Shareholder Proposals. Retrieved from https://www.isscorporatesolutions.com/

[11] Copland, J., & O'Keefe, M.M. (November 7, 2017). *Proxy Monitor 2017: Season Review*. Retrieved from http://www.proxymonitor.org/Forms/pmr_15.aspx/; ISS Corporate Solutions, Inc. (2018). Voting Analytics – Shareholder Proposals. Retrieved from https://www.isscorporatesolutions.com/

[12] Copland, J., & O'Keefe, M.M. (November 7, 2017). *Proxy Monitor 2017: Season Review*. Retrieved from http://www.proxymonitor.org/Forms/pmr_15.aspx

[13] Westcott, S. (Junes 2018). 2018 Proxy Season Brings Some Surprises. *The Advisor*. Retrieved from Alliance Advisors website: https://allianceadvisors.com/wp-content/uploads/2018/06/Alliance-Advisors-Newsletter-Jun.-2018-2018-Proxy-Season-Brings-Some-Surprises-1.pdf

[14] ISS Corporate Solutions, Inc. (2018). Voting Analytics – Proposals. Retrieved from https://www.isscorporatesolutions.com/

management time related thereto that could otherwise be spent on value-creating activities. These costs are borne by all shareholders, not just those making the proposal. There is also, of course, a cost to the resources of the Commission and its Staff. Further, the current proposal process risks obscuring matters of true economic significance to the company by potentially allowing annual meeting ballots to simultaneously present numerous immaterial proposals for consideration.

In October 2016, Business Roundtable suggested 10 pragmatic reforms to the shareholder proposal process to address our greatest concerns.[15] Certain aspects of the concerns we raised have been addressed by the Commission in subsequent Staff guidance, which we view as positive first steps.[16,17] However, as the Commission undertakes a comprehensive review of the proxy system, we believe the following reforms should be considered as additional steps to modernize the shareholder proposal rules to provide for more effective shareholder communication and engagement.

Increase the Threshold for Initial Proposal Submission. Under the current shareholder proposal rules, shareholders must only own $2,000 or 1 percent — whichever is less — of a company's stock for just one year to submit a proposal. The ownership threshold was implemented in 1983 and has only been updated once in the past 35 years, and then only an adjustment for inflation in 1998.[18,19] Based on current stock prices, the 1 percent threshold is entirely subsumed by the $2,000 ownership requirement, which falls well short of any reasonable material ownership standard for public companies. As a result, we believe the $2,000 ownership threshold for the submission of shareholder proposals needs modernization and should be increased significantly. In addition, to be eligible to submit a proposal, Business Roundtable believes all proponents, even those relying on a proxy to submit a proposal, should be required to meet the minimum ownership threshold.

Increase the Length of the Holding Requirement. The current one-year holding period encourages an undue focus on short-term goals. This holding requirement is also out of step with the three-year holding period more recently established through private ordering with respect to proxy access. Given that shareholder proponents are required to hold only $2,000 of a company's stock for just one year, as a practical matter, there currently is no mechanism to

[15] Business Roundtable (October 2016). *Responsible Shareholder Engagement and Long-Term Value Creation*. Retrieved from Business Roundtable website: https://www.businessroundtable.org/archive/resources/responsible-shareholder-engagement-long-term-value-creation

[16] SEC Division of Corporate Finance (November 1, 2017). *Shareholder Proposals* (Staff Legal Bulletin No. 14I). Retrieved from SEC website: https://www.sec.gov/interps/legal/cfslb14i.htm

[17] SEC Division of Corporate Finance (October 23, 2018). *Shareholder Proposals* (Staff Legal Bulletin No. 14J). Retrieved from SEC website: https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals

[18] Amendments to Rules on Shareholder Proposals (proposed), 62 Fed. Reg. 50682, at 50694 (September 26, 1997).

[19] Amendments to Rules on Shareholder Proposals (final), 63 Fed. Reg. 29106, at 29111 (May 28, 1998).

ensure that the shareholder proposal process is reasonably designed to further the interests of long-term shareholders and support the creation of long-term value. We believe the required holding period should be lengthened to better align the interests of the shareholders making the proposals with the long-term success of the company. In addition, we believe that proponents should have true economic exposure to the investment for the entire holding period, and not be able to rely on the shares of the owner whose proxy they hold.

Strengthen the Resubmission Thresholds. Companies are largely prevented from excluding repeat submissions of proposals (or those dealing with substantially the same subject matter), even when such proposals have been unsuccessful. Under current resubmission rules, proposals getting a mere 3 percent of the votes cast qualify for resubmission at least once, and for as long as a proposal obtains 10 percent of the votes cast, it may be resubmitted indefinitely. This structure allows a small subset of shareholders (or a proxy advisor voting on behalf of shareholders) to override indefinitely the expressed will of a substantial majority of shareholders. Companies have at times faced the same shareholder proposal for five or more years in a row (and sometimes for more than a decade), even as shareholders voting in favor of the proposals represent significantly less than a majority year after year. The argument that proposals should be allowed time to gain traction is far less compelling today, when activist shareholders are able to, and do, coordinate and advocate instantly via electronic media. We believe resubmission thresholds should be high enough to demonstrate that a resubmitted proposal is realistically on the path to majority approval. Accordingly, the resubmission thresholds the SEC itself proposed in 1997 — 6 percent on the first submission, 15 percent on the second and 30 percent on the third — would be more appropriate than today's thresholds.[20]

Enhance Proponent Disclosure Requirements. While companies must include in their proxy statement the proponent's name, address and number of voting securities the proponent owns (or an undertaking to provide the same upon request), proponents are not required to state their economic ownership in the company, the period of time of their investments or the breadth of their advocacy on the issue in question. Business Roundtable believes the rules governing the grounds to exclude a proposal should be amended to require proponents — and proponents by proxy — to disclose their motivations, goals, economic interests and holdings in the company's securities and any similar proposals they have submitted at other companies (as well as the results of those proposals), which would allow shareholders to make a better-informed decision about the proposal. Such a requirement would also enable shareholders to better evaluate the materiality and long-term value of the proposal to the company.

Enforce Limitations on the Use of Images. To avoid forcing companies to include immaterial and inflammatory content in their proxy statements, it is essential that the Commission have a clear and robust framework to evaluate images included in shareholder proposals. Recognizing the potential for abuse, in Staff Legal Bulletin 14I the Commission provided guidance regarding

[20] Amendments to Rules on Shareholder Proposals (proposed), 62 Fed. Reg. 50682, at 50689 (September 26, 1997).

the use of images in shareholder proposals.[21] The parameters set in the Staff's guidance are a sensible first step to curb a practice that had been used to circumvent securities regulations, and Business Roundtable appreciates the Commission's actions. As companies and proponents continue to test the application of the new guidance, we encourage the Commission to consistently enforce the restrictions it has adopted and allow companies to exclude proposals including images that are, among other things, false or misleading, offensive, protected by copyright, oversized, or otherwise aimed at circumventing the parameters with respect to supporting statements set forth in Rule 14a-8(d).

Reexamine the Rules Surrounding "No-Action" Relief.

Better Define the Criteria for Applying the Ordinary Business Exclusion. Companies seeking no-action relief under the "ordinary business" exclusion must contend with the fact that "ordinary business" has not been clearly or consistently defined. The Commission has stated that when analyzing an "ordinary business" exclusion, there are two central considerations: the subject matter of the proposal and the degree to which the proposal seeks to "micromanage" the company.[22] Under the first consideration, companies may exclude a shareholder proposal if the subject matter of the proposal relates "so fundamental[ly] to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight" unless, in the Staff's view, such matters focus on a significant social policy that are appropriate for consideration by the shareholders.[23] The second consideration looks at whether the proposal delves too deeply and into too much detail into matters of a complex nature such that shareholders would not be in a position to make an informed judgment on it. The Staff's approach to addressing questions regarding both the existence of a sufficiently significant social policy and micromanagement has varied. The Commission has said that it "applies the most well-reasoned standards possible, given the complexity of the task," but that, "from time to time, in light of the experience in dealing with proposals in particular subject areas, it adjusts its approach."[24] In Staff Legal Bulletin 14I, the Staff conceded that "these determinations often raise difficult judgment calls" and asked that companies begin providing the analysis of their boards of directors in no-action letters seeking exclusion under this provision.[25] Results from no-action letters following Staff Legal Bulletin 14I have continued to raise questions about the requirements for this exclusion and the value of including a board analysis. In an attempt to provide further guidance, the Staff recently released Staff Legal Bulletin 14J, which discussed the Staff's approach to evaluating the board analysis and issues of micromanagement. The Staff noted in Staff Legal Bulletin 14J that, unlike historical practice, it

[21] SEC Division of Corporate Finance (November 1, 2017). *Shareholder Proposals* (Staff Legal Bulletin No. 14I). Retrieved from SEC website: https://www.sec.gov/interps/legal/cfslb14i.htm

[22] Release No. 34-30018 (May 21, 1998).

[23] Ibid.

[24] Ibid. at 50688.

[25] SEC Division of Corporate Finance (November 1, 2017). *Shareholder Proposals* (Staff Legal Bulletin No. 14I). Retrieved from SEC website: https://www.sec.gov/interps/legal/cfslb14i.htm

will now agree to exclude proposals addressing executive and director compensation on the basis of micromanagement.[26] Business Roundtable appreciates that the Commission has attempted to provide additional guidance regarding the application of the "ordinary business" exclusion. However, since the approach to evaluating "ordinary business" exclusions has not been consistently applied, and to add to the Staff's recent efforts to build a more consistent approach, we recommend that the Commission implement expanded review and oversight procedures, developed with input from issuers and investors, to prevent arbitrary changes in direction.

Reinstate the Conflicting Proposal Exclusion. In 2015, the SEC revised its approach to the conflicting proposal exclusion, materially departing from decades of guidance. The SEC's new interpretation limits the ability of companies to exclude a shareholder proposal that conflicts with a company proposal unless "a reasonable shareholder could not logically vote in favor of both proposals, i.e., a vote for one proposal is tantamount to a vote against the other proposal."[27] The new interpretation risks confusing shareholders and intruding upon the fiduciary duties of directors. Further, this departure from long-established practice was adopted in a Staff Legal Bulletin without formal rulemaking. The Commission should reinstate the prior interpretation of the conflicting proposal exclusion to eliminate the risk of confusion that the new guidance presents.

Reevaluate the Standard for Excluding Proposals that are Contrary to Proxy Rules. Rule 14a-8(i)(3) permits the exclusion of proposals that are contrary to the SEC's proxy rules, including proposals that are materially false or misleading or that are overly vague. In 2004, the SEC Staff significantly curtailed the ability of companies to use this exclusion when it took the position that it will not allow a company to exclude a supporting statement or proposal — even if it contains unsupported factual assertions, is disputed or countered, impugns the company or management or relies upon unidentified sources — unless the company "demonstrates objectively that a factual statement is materially false or misleading."[28] Since that time, the Staff have found that very few statements meet this standard and have indicated that companies should use a "statement of opposition" to respond to any false or misleading statements.[29] As a result, a company may be faced with the decision whether to include in its proxy a proposal that contains misstatements but is not deemed excludable under SEC Staff standards or to instead engage in expensive litigation to enforce its right to exclude the proposal. The responsibility to make sure shareholder proposals are accurate and not misleading ought to be borne by the authors of proposals: the shareholder proponents. The

[26] SEC Division of Corporate Finance (October 23, 2018). Shareholder Proposals (Staff Legal Bulletin No. 14J). Retrieved from SEC website: https://www.sec.gov/corpfin/staff-legal-bulletin-14jshareholder-proposals

[27] SEC Division of Corporate Finance (October 22, 2015). *Shareholder Proposals* (Staff Legal Bulletin No. 14H). Retrieved from SEC website: https://www.sec.gov/interps/legal/cfslb14h.htm#_ednref15

[28] SEC Division of Corporate Finance (September 15, 2004). *Shareholder Proposals* (Staff Legal Bulletin No. 14B). Retrieved from SEC website: https://www.sec.gov/interps/legal/cfslb14b.htm

[29] Ibid.

Staff should reevaluate the current proponent-deferential standard it is applying to the exclusion of proposals contrary to proxy rules and place the burden back on proponents to demonstrate that their proposals are consistent with SEC rules.

Revise the Standard for Excluding Proposals on the Basis of Substantial Implementation. Rule 14a-8(i)(10) permits the exclusion of shareholder proposals if a company has already substantially implemented the proposal. The Commission has stated that "substantial" implementation does not require implementation in full or exactly as presented by the proponent.[30] However, over time, full or exact implementation of a proposal appears to have become the standard applied under paragraph (i)(10). At times, proposals request a report on a topic that is already addressed in communications with shareholders disclosing what the board believes to be the appropriate level and extent of information. Business Roundtable believes, consistent with the fiduciary duty of directors and the original intent of the Commission, that shareholder proposals requesting additional information on the same topic or seeking to address the same subject matter from a different point of view should generally be excludable on the basis of substantial implementation.

Revise the "No-Action" Letter Process. Based on a recent survey of our members, only about 20 percent of respondents believe the SEC's no-action letter process is administered in a consistent and transparent manner. The current no-action letter process is administered at the Staff level at the SEC, with presidentially appointed SEC Commissioners who bear ultimate accountability for SEC actions possessing little authority to reconsider a Staff decision. This decentralized issue-by-issue review, especially over the course of time, leads to inconsistent guidance and interpretation of the rules. To make the guidance process more consistent, the Commission could convert the no-action letter process into an SEC advisory opinion process, whereby the SEC issues opinion on major policy issues rather than issuing no-action letters. Alternatively, the process should be adjusted to allow for enhanced review and oversight mechanisms to achieve greater consistency.

Reforming the Regulation of Proxy Advisory Firms

Institutional investors, who, as noted above, own 70 percent of all public company shares in the United States, often rely on proxy advisory firms to help advise them on how best to manage their fiduciary duty to vote their proxies in the best interest of the beneficial owners they represent.[31] Based largely on the Rule 206(4)-6 adopting release and two recently withdrawn no-action letters, institutional investors have for some time operated under the belief that they could avoid potential conflicts of interest by voting their proxies in accordance with the

[30] Amendments to Rules on Shareholder Proposals (final), 63 Fed. Reg. 29106, at 29120 (May 28, 1998).

[31] Broadridge Investor Communication Solutions, Inc. and PricewaterhouseCoopers LLP (October 2018). *Proxy Pulse: 2018 Proxy Season Review*. Retrieved from https://www.broadridge.com/report/2018-proxy-season-review?id=00203PPRUSA15JUNLPG02PPR&so=se&po=&di=&ct=&ot=rp&mt=oc&yr=18&rg=us&on=01&ep=pd&gclid =EAIaIQobChMIzar1rcmV3gIVF7bICh1D1QYoEAAYASAAEgKYO_D_BwE

recommendations of proxy advisory firms, including those that provide consulting services.[32,33] In addition, many institutional investors have interpreted SEC and Department of Labor rules and guidance as requiring institutional investors to vote on every matter on a proxy.[34] Since many institutional investors lack the personnel and back-office support to manage such extensive voting obligations, they have sought to outsource these tasks to proxy advisory firms. As a result of the combined effect of the foregoing, proxy advisory firms have come to wield enormous influence over shareholder voting at public companies.

The market for proxy advisory services is dominated by two companies. Institutional Shareholder Services Inc. ("ISS") and Glass Lewis & Co. ("Glass Lewis") effectively operate as a duopoly, enjoying a 97 percent combined market share.[35] Academic studies have produced varied conclusions regarding the degree to which proxy advisory firms influence voting outcomes, but a recent report generated three important findings based on an extensive review of the research: (1) an adverse recommendation on a proposal from a proxy advisory firm is associated with a reduction in the favorable vote count by 10 percent to 30 percent, (2) proxy advisory firms' influence on voting is generally shown to be *at a minimum* moderate, and (3) proxy advisory firms' influence on corporate behavior and shareholder value is generally shown to be negative.[36]

While Business Roundtable recognizes that proxy advisory firms play an important role in the proxy system, we also believe there are serious concerns with the current system that need to be addressed. Specifically, there has been continued concern that proxy advisory firms produce reports that frequently include factually inaccurate information, that they are not transparent with respect to their methodologies and procedures and that they have conflicts of interest. In addition, there is no indication that proxy advisory firms test their voting guidelines and recommendations to confirm that they are consistent with long-term value creation. Further, proxy advisory firms are subject to little regulatory oversight and there are questions as to whether some institutional investors are complying with their fiduciary duties related to the voting of the shares they control as well as duties to oversee the proxy advisory firms they retain.

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[32] SEC Rule 206(4)-6, 17 C.F.R. §275.206(4)-6 (2018). Release IA-2106.

[33] SEC No-Action Letter to Egan Jones Proxy Services (May 27, 2004) (withdrawn September 13, 2018); SEC No-Action Letter to Institutional Shareholder Services, Inc. (September 15, 2004) (withdrawn September 13, 2018).

[34] Gallagher, D.M. (August 2014). Outsized Power & Influence: The Role of Proxy Advisers. *Washington Legal Foundation Critical Legal Issues Working Paper Series*. Retrieved from https://s3.us-east-2.amazonaws.com/washlegal-uploads/upload/legalstudies/workingpaper/GallagherWP8-14.pdf

[35] Glassman, J.K., & Peirce, H. (June 18, 2014). *How Proxy Advisory Services Became So Powerful*. Retrieved from Mercatus Center website: https://www.mercatus.org/publication/how-proxy-advisory-services-became-so-powerful

[36] Copland, J., Larcker, D.F., & Tayan, B. (May 30, 2018). *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry* (Working Paper No. 3679). Retrieved from Stanford Graduate School of Business website: https://www.gsb.stanford.edu/faculty-research/working-papers/big-thumb-scale-overview-proxy-advisory-industry

Business Roundtable believes that the investing public would benefit from reforms, including the following, that would improve the accuracy, transparency and accountability of proxy advisory firms.

Increase Accuracy of Recommendations. Concern has long been raised that proxy advisory firm recommendations often include errors, material factual inaccuracies and incomplete analyses. In 2013 and again in 2018, a survey of Business Roundtable CEO members found that nearly all respondents found one or more factual errors in reports prepared by proxy advisory firms about their companies.[37] The 2018 survey results further indicate that although 90 percent of companies notify the proxy advisory firms of the errors, only 8 percent of companies find that the errors are consistently corrected. Additionally, even if errors are corrected in the report, our members have noted that corresponding updates are not necessarily made to the recommendations. The majority of our members responding to the survey have also pursued opportunities to meet with proxy advisory firms, but only 33 percent report that their efforts have consistently resulted in meetings. Further, nearly one in five respondents who met with proxy advisory firms to discuss their reports was unsatisfied with the outcome of those interactions.

A better mechanism needs to be in place to ensure investors are receiving accurate information. We believe proxy advisory firms should provide public companies with copies of their draft reports a reasonable time before dissemination to their clients to enable companies to review the reports, correct inaccurate information and make any significant comments.[38] During this review period, proxy advisory firms need to clearly and transparently show their methodologies and calculations. Figures included in proxy advisory firms' reports and voting recommendations should be reconciled to figures in the companies' public filings. It is impossible for companies or investors to verify the accuracy of numerical data in proxy advisor reports without access to the underlying calculations. Companies should also be allowed to share draft reports with their legal counsel and other advisers on a confidential basis. If any errors or concerns are identified, the proxy advisory firm should engage with the company to understand the issue and correct errors promptly.

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[37] Business Roundtable (September 12, 2013). *Letter to SEC Chairman White on Proxy Advisory Firms*. Retrieved from Business Roundtable website: https://www.businessroundtable.org/archive/resources/letter-to-chairman-white-on-proxy-advisory-firms

[38] ISS provides draft reports to S&P 500 companies with a limited window for comment, but Glass Lewis does not (although it does provide an "Issuer Data Report" for a fee). The ISS review period is generally short. At the 2013 Proxy Advisory Firms Roundtable, ISS President Gary Retelny noted that their target was a 24- to 48-hour review time. However, some respondents to a recent joint survey from Nasdaq and the Center for Capital Markets Competitiveness indicated receiving as little as 30 to 60 <u>minutes</u> to review the report, and 36 percent of respondents to a recent survey of public companies indicated they received fewer than 12 hours to review the report. Only 15 percent of respondents in the same survey of public companies reported receiving more than 72 hours to review the report. These periods are all shorter than the five days many believe necessary to communicate with shareholders on a negative recommendation.

Business Roundtable members also express concern that, when making recommendations, proxy advisory firms include or rely upon information not included in the company's public SEC filings or base their recommendations on factors other than the regulatory scheme to which companies are subject. For instance, proxy advisory firms have their own guidelines for determining independence of directors. This has resulted in situations where a proxy advisory firm recommends against the election of a director because it has determined a director is not independent under its standards, despite the fact that the company's board of directors, carrying out its fiduciary duties, determined that the director in question was independent under the requirements of the Commission and the company's stock exchange listing rules and corporate governance guidelines. Similarly, Glass Lewis has announced that beginning in 2019 it may recommend a vote against members of a company's governance committee if the company excludes shareholder proposals through a valid use of the no-action letter process.[39] This decision will hinge on whether Glass Lewis, in its own determination, believes exclusion of the shareholder proposal was "detrimental to shareholders." As a result, companies will now need to contend with the reality that a legitimate use of the Commission's no-action letter process could result in votes against directors based on the subjective views of a proxy advisory firm. The Commission should reaffirm the fact that proxy advisors who rely on an exemption from proxy solicitation rules under Rule 14a-2(b) are still subject to liability for false and misleading statements under Rule 14a-9 and should specifically make clear whether these anti-fraud provisions apply when proxy advisory firms' voting reports include information, statements or opinions that have not been included in material filed with the Commission.

Finally, proxy advisory firms should publicly disclose the final voting report about a public company 90 days after a shareholder meeting has occurred, which would, among other things, allow for analysis of the effect proxy advisory firm recommendations have on long-term shareholder value.

Implement Additional Transparency Requirements. Proxy advisory firms offer little transparency into their internal standards, procedures and methodologies. Neither ISS nor Glass Lewis fully discloses the methodologies used to develop their voting recommendations. As a result, it is not possible to determine the degree to which any factors, including pressure to conform to the agenda of large clients of the proxy advisory firms and the demand for proxy advisory firm consulting services, are driving updates to voting guidelines. ISS, in particular, has an economic incentive to make its policies opaque and complex and to change them frequently to increase demand for its consulting services from issuers. For example, as part of its "2019 Benchmark Policy Comment Period," ISS has proposed switching its Financial Performance

[39] Glass, Lewis & Co. (October 24, 2018). *2019 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice – United States*. Retrieved from http://www.glasslewis.com/wp-content/uploads/2018/10/2019_GUIDELINES_UnitedStates.pdf

Assessment measures from GAAP-based measures to Economic Value Added (EVA) measures, notably in the same year that ISS acquired EVA Dimensions LLC.[40]

ISS and Glass Lewis also do not disclose academic research, if any, that is used in formulating their recommendations and whether the recommendations were designed to promote the creation and preservation of long-term shareholder value. To allow investor clients to fulfill their own fiduciary obligations to oversee and assess the policies and methodologies of proxy advisors upon whom the investors rely, we believe proxy advisory firm disclosures should explain how the proxy advisory firm has determined that its voting policies and methodologies are consistent with the best long-term interests of shareholders, including addressing any new or additional empirical studies or evidence on the subject of voting issues and shareholder value.

The need for additional transparency has been raised particularly around issues of executive compensation and employee incentive plans, where Business Roundtable members report the criteria used are not generally well understood and are inflexible when applied. In order to increase transparency with respect to these matters, to the extent that a proxy advisory firm's analysis and recommendation utilizes information different from what the company filed (e.g., peer group or value of option grant), the proxy advisory firm should be required to disclose not just the fact that different information was used, but also illustrate what the analysis would have been if the company's filed information had been used.

Proxy advisory firms also set certain requirements, the bases for which are unclear, and compliance with which is based on a subjective analysis (e.g., whether a board has been "responsive" to a say-on-pay vote receiving less than 70 percent of the vote). The degree to which proxy advisory firms outsource their fact-gathering and analysis to third-party raters and rankings, especially in the environmental, social and governance space, has also been a growing concern. While there may be justification to exclude certain proprietary information, proxy advisory firms should be required to provide more transparency into their internal controls, policies, procedures, guidelines, and methodologies and to disclose when and why they choose to deviate from their stated standard practices.

Further, proxy advisory firms' criteria and requirements for evaluating matters subject to a vote should be published before the beginning of the fiscal year in which the matters arise. For example, a change in criteria published in November 2018 ought to apply only to issuers' fiscal years beginning after that date. At present, changes to criteria published in November 2018 would apply retroactively, in the case of a calendar-year issuer, to the company's policies and actions beginning on January 1, 2018.

[40] Institutional Shareholder Services Inc. (February 12, 2018). *ISS Announces Acquisition of EVA Dimensions*. Retrieved from ISS website: https://www.issgovernance.com/iss-announces-acquisition-of-eva-dimensions/

Increase Disclosure of Conflicts of Interest. Several aspects of the current ownership and operations of proxy advisory firms create the potential for conflicts of interest. For example, Glass Lewis is owned by the Ontario Teachers' Pension Plan and Alberta Investment Management Corp., which invest in companies on whose proxies Glass Lewis makes recommendations, and ISS is owned by a private equity firm.[41,42] In addition, proxy advisory firms may be incentivized to align their recommendations with the interests of their clients, who may be proponents of a matter to be voted on at a shareholder meeting or who may have a specific agenda on governance, executive compensation or other matters. Further, ISS (unlike Glass Lewis) provides consulting services to the same public companies whose proxy proposals they evaluate and provide recommendations on.

These conflicts need to be addressed. Staff Legal Bulletin 20 was a good first step, making clear that to qualify for the exemption from certain proxy rules, proxy advisory firms must proactively and specifically disclose "significant" or "material" interests the proxy advisory firm has "in the matter that is the subject of the voting recommendation." However, Business Roundtable believes there is still room for improvement with respect to disclosure of conflicts of interest. At a minimum, proxy advisory firms should provide conflict of interest disclosures that are prominently displayed and describe specific conflicts, instead of relying on generalized statements about conflicts of interest. For instance, proxy advisory firms should disclose to their clients when they are providing voting recommendations on shareholder proposals submitted by their institutional investor clients and when the subject company has received consulting services from the proxy advisory firm on proxy matters.

Reduce Reliance on Arbitrary Methodology and Ensure Appropriate Staffing. Proxy advisory firm voting policies are generally developed using a one-size-fits-all approach, leading in many instances to the same standards being applied to all public companies without regard to, or understanding of, a specific company or its industry. Compounding this issue is concern over whether proxy advisory firms have sufficient and knowledgeable staffing for the proxy review process. ISS reports that it employs approximately 1,200 individuals and provides proxy recommendations for 42,000 shareholder meetings, and Glass Lewis reports that it employs approximately 360 individuals and provides proxy recommendations for 20,000 shareholder meetings.[43,44] Business Roundtable member companies report that proxy advisory reports frequently misinterpret information due to their limited understanding of the company and its operations. Especially in light of the short time frame during which the bulk of the proxy season takes place each year, proxy advisory firms should ensure that they have sufficient staff to produce proxy voting recommendations that are based on accurate and current information and that the staff formulating voting recommendations for specific companies possess an

[41] Company Overview. (2018). Retrieved from http://www.glasslewis.com/company-overview/

[42] ISS History. (2018). Retrieved from https://www.issgovernance.com/about/iss-history/

[43] The Global Leader in Corporate Governance & Responsible Investment. (n.d.). Retrieved from https://www.issgovernance.com/about/about-iss/

[44] Company Overview. (n.d.). Retrieved from http://www.glasslewis.com/company-overview/

appropriate level of background knowledge and industry expertise to properly evaluate the issues at hand. As a matter of best practice, proxy advisory firms should disclose the extent to which they engage with issuers to develop both general voting policies and company-specific recommendations to ensure that they fully understand the matters on which they provide guidance. Proxy advisors should also disclose to their clients whether a recommendation is based on their general standards or a company-specific analysis.

Develop and Employ a Uniform Regulatory Framework. Despite their significant influence on the shareholder voting process, proxy advisory firms are not subject to regular and uniform regulatory oversight. Glass Lewis is not currently subject to any regulatory supervision, and, while ISS and other proxy advisory firms are registered under the *Investment Advisers Act of 1940* (the "'40 Act"), regulation under the '40 Act does not reflect the unique role proxy advisory firms play in the proxy system. Consequently, under the current proxy advisory system, entities that have no economic stake in the outcome of the voting on which they advise are able to influence the vote of institutional investors without being governed by uniform regulation and disregarding the regulatory schemes that are in place. Given the importance of proxy advisory firms' recommendations on proxy voting and to create more certainty, proxy advisory firms should be subject to a uniform set of rules and more robust oversight by the SEC.

The Commission should consider requiring proxy advisory firms to register under the '40 Act under a new regulatory framework that defines an "independent" third party advisor to more appropriately reflect the role proxy advisory firms perform in the proxy voting process.[45,46] At a minimum, this more tailored set of regulations would require proxy advisory firms to (1) establish, maintain and enforce written policies and procedures to address conflicts of interest; (2) establish, maintain and enforce a written code of ethics and professional conduct; (3) establish, maintain and enforce an effective internal control structure governing the implementation of and adherence to the policies, procedures, guidelines and methodologies used to provide proxy voting recommendations to persons with whom the proxy advisory firm has a business relationship; (4) provide for website disclosure of the policies, procedures, guidelines and methodologies used by each proxy advisory firm to develop proxy voting recommendations; and (5) require proxy advisory firms to maintain records and file annual or other reports required by the SEC.

Another approach would be to require that proxy advisory firms meet certain additional minimum requirements governing their activities and conduct to qualify for the exemption from the proxy rules on which they currently rely. These additional requirements could be tied to, among other things, making proxy advisory firm voting reports more accurate, making their

[45] SEC Rule 206(4)-6, 17 C.F.R. §275.206(4)-6 (2018). Release IA-2106.

[46] SEC Division of Corporate Finance, SEC Division of Investment Management (June 30, 2014). *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms* (Staff Legal Bulletin No. 20). Retrieved from SEC website: https://www.sec.gov/interps/legal/cfslb20.htm

methodologies and conflicts more transparent and prohibiting prepopulated voting when an adverse recommendation has been issued.

Focus on Responsibilities of Investment Advisers. If institutional investors choose to use the services of proxy advisory firms and the information they provide, these investors retain ultimate responsibility to vote their proxies in the best interests of their beneficial owners and, as a result, have a responsibility to oversee the proxy advisory firms they retain. Staff Legal Bulletin 20 provides a good starting point regarding how investment advisers should oversee the proxy advisory firms they retain, but greater attention needs to be paid to whether institutional investors are appropriately exercising their fiduciary duties in making voting decisions.

While companies recognize that many institutional investors use proxy advisory firm recommendations as one part of their proxy voting analysis, companies have voiced particular concern that some institutional investors rely on the recommendations of proxy advisory firms and allow their votes to be cast automatically without first evaluating recommendations to ensure that the vote is in the best interests of their clients. Supporting this contention are results from a recently conducted survey, which revealed a spike in voting in response to adverse voting recommendations by ISS during the 2017 proxy season. During the three business days immediately after the release of an adverse recommendation, the survey showed that an average of 19.3 percent of the total shareholder vote was submitted consistent with the adverse voting recommendation.[47] This practice is troublesome for several reasons. A high incidence of voting immediately on the heels of proxy advisory reports suggests that investors spend little time evaluating proxy advisory firms' guidance and determining whether it is in the best interests of their clients. Investors also would not have an opportunity to identify inaccuracies in the reports or an ability to consider proxy advisory firms' methodologies or potential conflicts in making their recommendations. Further, this rushed voting significantly curtails the ability of companies to advocate for themselves when facing an adverse recommendation, as votes may be cast before companies even have time to respond to the proxy advisory firm regarding an adverse recommendation or engage with shareholders on the issue. We believe this issue warrants further evaluation by and guidance from the Commission.

As the Commission further considers the oversight responsibilities of investment advisers, we also believe the September 2018 withdrawal of the Egan-Jones and ISS no-action letters invites discussion regarding how institutional investors ensure compliance with their fiduciary duties when using the services of a proxy advisory firm.[48] Any new SEC rules or guidance should emphasize the responsibility of each registered investment adviser to exercise appropriate

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[47] Placenti, F.M. (October 2018). *Are Proxy Advisors Really a Problem?* Retrieved from American Council for Capital Formation website: http://accfcorpgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf

[48] SEC Statement Regarding Staff Proxy Advisory Letters (September 13, 2018). Retrieved from SEC website: https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters

oversight over its proxy voting process and ensure its voting decisions on client securities are in its clients' best interests.

Reforming Shareholder Communications and the Proxy Voting Process and Increasing Retail Shareholder Participation

The current shareholder communication system and proxy voting process are cumbersome, circuitous and expensive for public companies. Public companies may directly communicate with and solicit proxies from their registered shareholders, who generally include the company's employees, directors and pension funds, but these shareholders typically represent only about 25 percent of the ownership of a company's stock.[49] To communicate with or solicit proxies from the remaining 75 percent to 85 percent of shareholders, who hold their stock in "street name," public companies must go through intermediaries, primarily banks and brokers.[50]

The street name ownership system was created in response to the paperwork crisis of the 1970s to process and clear securities transactions more efficiently.[51] For that purpose, street name ownership works well. As applied to shareholder communications and proxy voting, however, the current system results in inefficiencies, inaccuracies and added costs. In addition, the system does not take full advantage of technological advancements, like internet voting and blockchain technology, that could make direct communications more feasible and potentially revolutionize the entire proxy process.

Further complicating effective communication with shareholders are the SEC's rules prohibiting companies from communicating directly with beneficial owners who object to providing their names and addresses to companies (so-called "OBOs"). Information regarding the ultimate beneficial owners of street name shares is maintained by banks and brokers and not the companies themselves. Banks and brokers are required to provide companies lists of names and addresses only for beneficial owners who have not objected to having their information shared with the company (so-called "NOBOs") upon request, but they may not provide companies with such information for OBOs. The primary reason given for the creation of the NOBO/OBO distinction was privacy, but it is not clear that investors value this anonymity or truly understand the implications of becoming an OBO.[52,53] Because OBOs are estimated to

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[49] Racanelli, V.J. (July 6, 2018). Proxy Voting is Broken and Needs to Change. *Barron's*. Retrieved from https://www.barrons.com/articles/proxy-voting-is-broken-and-needs-to-change-1530924318

[50] Ibid.

[51] Ibid.

[52] Opinion Research Corporation (April 7, 2006). *Investor Attitudes Study* (finding that only 20 percent of investors remembered being asked if they wanted their contact information provided companies in which they own stock). Retrieved from http://www.shareholdercoalition.com/sites/default/files/ NYSE%20ORC%20Investor %20Study%204-7-06_0.pdf

[53] Studies conducted during the development of the NOBO/OBO system indicate that only between 8 and 12 percent of street name holders raised an objection to disclosure of their names to companies. SEC Advisory

constitute 75 percent of shares held in street name and the majority of total beneficial ownership of most public companies' shares, the current rules create significant obstacles to public companies' identification of and direct communication with a substantial number of their ultimate owners.[54]

Business Roundtable believes that the current system plays a major role in depressing the proxy voting participation of retail holders. While institutional investors were estimated to have 91 percent voting participation in 2018, during the same period, retail investors, who own around 30 percent of public company shares, were estimated to achieve only 28 percent voting participation.[55] A more streamlined and direct system of communication and proxy voting is essential to increasing retail shareholder participation. Business Roundtable has advocated for reform of the shareholder communications and proxy voting process for over a decade, and the current dynamics of the marketplace — ownership composition, activism trends, and regulatory and corporate governance changes (e.g., limitations on broker discretionary voting, say-on-pay vote requirements, and increased use of majority voting standards in director elections) — make the need for reform more important than ever.[56]

Business Roundtable believes the following potential reforms would help to make the shareholder communications and proxy voting processes more efficient and increase retail shareholder participation by addressing many of the underlying and interconnected elements in the process.

Suggested Improvements to the Shareholder Communication System

Provide for Direct Communications with All Beneficial Owners. As an initial matter, the NOBO/OBO distinction unduly impedes and unnecessarily complicates communications with beneficial owners. To improve communications between companies and their shareholders, remove unnecessary costs and delays, and increase retail shareholder participation, we believe

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Committee on Shareholder Communications (1982). Improving Communications between Issuers and Beneficial Owners of Nominee Held Securities. Retrieved from https://www.sec.gov/comments/s7-14-10/s71410-29.pdf. SEC Division of Corporate Finance (1980). Report to Senate Comm. On Banking, Housing and Urban Affairs: Staff Report on Corporate Accountability (96th Cong. 328).

[54] Beller, A.L., & Fisher, J.L. (February 2010). *The OBO/NOBO Distinction: Implications for Shareowner Communications and voting*. Retrieved from Council of Institutional Investors website: https://www.cii.org/files/publications/white_papers/02_18_10_obo_nobo_distinction_white_paper.pdf

[55] Broadridge Investor Communication Solutions, Inc. and PricewaterhouseCoopers LLP (October 2018). *Proxy Pulse: 2018 Proxy Season Review*. Retrieved from https://www.broadridge.com/report/2018-proxy-season-review?id=00203PPRUSA15JUNLPG02PPR&so=se&po=&di=&ct=&ot=rp&mt=oc&yr=18&rg=us&on=01&ep=pd&gcli d =EAIaIQobChMIzar1rcmV3gIVF7bICh1D1QYoEAAYASAAEgKYO_D_BwE

[56] Business Roundtable (April 12, 2004). *Request for Rulemaking Concerning Shareholder Communications* (SEC File No. 4-493). Retrieved from SEC website: https://www.sec.gov/rules/petitions/petn4-493.htm

this distinction should be eliminated. Brokers and banks should be required to provide companies with contact information for all beneficial owners (not just NOBOs), which would facilitate more complete and accurate shareholder lists, enabling a company to communicate directly with all its owners. Companies should also be permitted to send proxy materials to and solicit proxy cards directly from all shareholders (not just registered holders).[57]

To the extent they exist, we believe privacy concerns raised by elimination of the NOBO/OBO distinction can be mitigated through regulation. The SEC could implement rules enabling investors who wish to remain anonymous to use nominee names or custodial arrangements to hold their shares, at their own expense. Rules could also enable individual shareholders with concerns regarding the type and frequency of communications — from the company or other shareholders — to set their communication preferences electronically to limit contacts to those they find relevant.

Provide National Investor Education. In conjunction with new voting and shareholder communication systems, Business Roundtable believes a national investor educational program would help retail investors understand the proxy voting process and encourage participation in voting.

Suggested Improvements to the Proxy Voting Process

Authorize Beneficial Owners to Vote Directly. As mentioned above, Business Roundtable believes to reduce costs, increase participation and make the system more efficient, companies should be permitted to solicit proxies from beneficial owners directly. As a corollary, the Commission should consider requiring brokers, banks and their agents to provide beneficial owners with the authority to vote their shares directly (instead of requiring instructions to the broker-dealers to vote on their behalf). This could be accomplished by requiring the intermediaries to execute omnibus proxies transferring the legal right to vote the shares from broker-dealers and banks to the beneficial owners. Another possible approach would be to allow the beneficial owners to vote directly with the company, eliminating the need for an omnibus proxy. We believe either approach would be an improvement on the efficiency and accuracy of the current process of vote tabulation through the imperfect tandem of voting instructions and broker discretionary voting.

Require Beneficial Owner List Reconciliation. Brokers typically hold shares in fungible bulk, meaning there is no allocation of the shares into separate investor accounts, resulting in an inability to match long and short positions. When shares have been lent, the person who purchased the securities from the short seller and the person who loaned the shares to the

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[57] Although companies have the right to mail proxy materials directly to NOBOs, as a practical matter, that does not happen because current SEC rules require companies to forward proxy materials through brokers and banks regardless of whether they are also directly mailed. Brown, R. (1988). The Shareholder Communication Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility? *The Journal of Corporation Law*. Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=993866

short seller can sometimes both receive voting requests, which can lead to inaccuracy and confusion with the vote counts. To create a more transparent and accurate proxy voting system, the Commission should consider requiring broker-dealers to reconcile beneficial owner positions legally eligible to vote as of a record date prior to mailing the voter instruction form and/or proxy materials. This would help prevent over-voting and under-voting resulting from instructions and proxy cards being mailed in by shareholders who are not entitled to vote and who should not have received materials. It would also reduce the associated waste.

Create Competition Among Proxy Service Providers. Business Roundtable continues to believe that opening proxy services to free market competition would foster innovation and help to create a more efficient and cost-effective shareholder communication and proxy system. One possibility warranting further consideration is the separation of the functions of beneficial owner data aggregation and proxy communications distributions, which the Commission discussed in the 2010 Concept Release.[58] In this system, a data aggregator selected in a competitive bidding process by a Self-Regulatory Organization or other independent body would maintain lists of beneficial owners used for shareholder meetings and other communications purposes involving the corporate or business affairs of the company. This beneficial owner information would also be available to service providers who could offer proxy distribution and tabulation services to the company. Such an approach to proxy distribution would allow competitive market forces to dictate prices for beneficial owner proxy services in place of the current standardized fees set by Self-Regulatory Organizations. It would also allow companies to directly distribute proxy materials to all shareholders and select the service providers themselves, rather than placing the decision in the hands of intermediaries who have no incentive to negotiate lower costs for shareholders.

Consider Enhancing Investor Disclosure Requirements. We continue to share the Commission's concern raised in the 2010 Concept Release about hedging strategies and share lending practices that decouple voting power from economic interest and agree that as they relate to proxy voting these practices require additional study. As further evaluation is pending, we believe the Commission should consider requiring increased disclosure by investors holding voting power decoupled from an economic interest.[59]

Evaluate and Provide for the Use of Technological Advancements. There have been substantial developments in technology since the 2010 Concept Release. To the extent technology can be employed to further the efficiency of reforms, we believe it should be considered and explored. For instance, if omnibus proxies are used to authorize beneficial owners to vote directly, beneficial owners should be permitted to use the same internet voting platforms available to registered owners.

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[58] SEC Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42982, at 42997 (July 22, 2010).

[59] As a note, in the context of Section 13(d) disclosures, Business Roundtable supports expanding disclosure of derivatives that decouple economic interests from voting and investment control, as is discussed later in this comment letter.

Business Roundtable also believes that blockchain technology and smart contracts warrant study and consideration as potential tools to help modernize and simplify the proxy process. Proponents of the technology believe blockchain platforms could provide faster and more accurate vote tabulations with the potential for equal, real-time transparency, and service providers have already begun testing blockchain technology applications in the proxy process. For instance, Nasdaq has created a blockchain-based voting and proxy assignment application that has been tested in its Estonia and South Africa markets, which allows for, among other things, more transparency and auditability of voting results.[60,61] In addition, Broadridge (partnering with JPMorgan Chase and Northern Trust as custodian banks) used blockchain technology to allow certain shareholders of Banco Santander to participate in a shadow vote run parallel to the official vote for Santander's annual general meeting in March 2018. Broadridge noted that the shadow vote allowed institutional investors the opportunity to see how their votes could be counted and confirmed much more quickly with blockchain technology — stating it will be possible to do this instantaneously as opposed to the two-week wait time with the current process.[62]

The specific uses of blockchain technology in the proxy process are still being developed, and many questions still need to be answered regarding how a transition to a blockchain-based proxy system could work. However, we believe that these and other developing technologies show great promise and warrant consideration as additional tools to enhance the current proxy process.

Other Proposed Reforms Related to the Proxy Process

Universal Proxy Cards

In October 2016, the SEC proposed rules that, if adopted, would create a universal proxy card distributed by both the company and the dissident shareholder that would list all director nominees regardless of whether they were nominated by the board or the dissident. In January

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[60] Nasdaq Corporate Solutions (November 22, 2017). *Nasdaq to Deliver Blockchain e-Voting Solution to Strate*. Retrieved from http://ir.nasdaq.com/news-releases/news-release-details/nasdaq-deliver-blockchain-e-voting-solution-strate

[61] Nasdaq, Inc. (2018). *Nasdaq Blockchain Strategy: Moving Beyond the POC*. Retrieved from https://business.nasdaq.com/media/Blockchain%20Mutual%20Fund%20Strategy%20SEB%20and%20Nasdaq%202018_tcm5044-61791.pdf

[62] Broadridge Financial Solutions, Inc. (May 17, 2018). *Press Release: Santander and Broadridge Complete a First Practical use of Blockchain for Investor Voting at an Annual General Meeting*. Retrieved from Broadridge website: https://www.broadridge.com/press-release/2018/santander-and-broadridge-completed-practical-use-of-blockchain

2017, Business Roundtable wrote a comment letter to the SEC in response to the proposed universal proxy rules noting its concerns with the rules as proposed.[63] In the event that universal proxy cards are reconsidered at the upcoming roundtable, Business Roundtable would like to reiterate its concerns with rules that would mandate their use.

The use of universal proxy cards has the potential to create information inequities that disadvantage and disenfranchise shareholders. The SEC's proposed rules did not include a requirement for a dissident shareholder to send its proxy materials to all shareholders, instead only requiring distribution of materials to a voting majority. As a result, many shareholders, including many retail and small institutional shareholders, could receive a "universal" proxy card that lists the names of the company's and the dissident's nominees but would not receive the dissident's proxy materials, including the biographies of its nominees. This may lead to an information disadvantage for shareholders and discourage shareholders from participating in the election. Further, the inclusion of all director nominees on a single card creates a risk that shareholders may attempt to vote for more nominees than can be elected, resulting in the votes being entirely invalidated. Finally, the inclusion of dissident nominees alongside the company's nominees on a single card may suggest to shareholders a false equivalency between the company-vetted candidates and the dissident's slate, who may not possess the skills and qualifications necessary to be effective directors if elected.

Business Roundtable is also concerned that mandating the use of universal proxy cards could further encourage short-term focus at the expense of long-term shareholder value. Business Roundtable believes that mandated universal proxy cards would likely encourage an increase in the number of proxy contests, which are costly both in monetary terms and in the company's attention and focus, and which can put pressure on directors to de-emphasize long-term initiatives in favor of the short-term demands that dissident shareholders sometimes favor.

Exchange Act Section 13(d) Reform

Arguably the most contentious and high-profile use of the proxy system is a proxy contest. In recent years, these battles have highlighted the need for a better proxy system.[64] Proxy contests have also shed light on the broader, related issue of whether the regulations governing the build-up of beneficial ownership by activist investors prior to a fight for control are in need of reform. In undertaking an evaluation of the proxy system as a whole, Business

[63] Business Roundtable (January 9, 2017). *Letter to SEC Secretary Fields*. Retrieved from Business Roundtable website: https://www.businessroundtable.org/brt-letter-raises-concerns-over-secs-proposed-rules-for-universal-proxy-requirement

[64] For example, the 2017 proxy contest between Procter & Gamble and activist investor Trian Fund Management was the most expense proxy fight in U.S. history, costing both sides $60 million. After three weeks of evaluating disputed votes and trying to determine a winner, the proxy contest eventually ended in a settlement with Trian's CEO Nelson Peltz being appointed to the board of directors, even though he did not receive a majority of the votes; *see* Racanelli, V.J. (July 6, 2018). Proxy Voting is Broken and Needs to Change. *Barron's*. Retrieved from https://www.barrons.com/articles/proxy-voting-is-broken-and-needs-to-change-1530924318

Roundtable believes it is important for the Commission to consider potential reforms to the current 13(d) reporting system to ensure those rules and regulations continue to promote their stated goals and provide companies with adequate remedies to protect their shareholders from violations of the rules.

Adopted in 1968, Section 13(d) of the Securities Exchange Act of 1934 requires a person who indirectly or directly becomes the beneficial owner (or any such group of beneficial owners) of more than 5 percent of a company's registered equity securities to disclose his or her ownership within 10 days of acquisition. The provision was designed "to alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control."[65] Business Roundtable believes modern technology and investor practices have combined to vitiate much of the statute's intended effect, leaving companies and their shareholders with little transparency and without adequate remedies.

This issue has become more pronounced as companies have faced a significant rise in hedge fund activism. Activists have been able to exploit the current disclosure rules and regulations to accumulate large positions in secret during the 10-day filing window following the date an activist chooses to cross the 5 percent disclosure threshold. Once disclosure of their ownership is required, the activist can use its new position (often aided by a loose coalition of other hedge funds and investors coordinated during the filing window) to demand changes that may not be in the long-term interests of other stockholders or company stakeholders, including employees and creditors.[66] The potential benefits of hedge fund activism are hotly debated; however, even recognizing that such activism may at times play a productive role in corporate governance, we do not believe activists should be able to conceal from the company and its shareholders their true ownership and the affiliations they have forged as they seek to affect the control of the company. Much like companies have a duty to inform the market of material developments in a timely manner, activists seeking control should be required to provide timely and transparent disclosures.

Business Roundtable is also concerned that the threat of shareholder activism can deter companies from going public, especially in the technology sector where projects may require longer lead times for completion. Reforming the current disclosure rules could help make going public more attractive.

Calls for reforming the 13(d) reporting system are not new.[67] Given the effect the 13(d) reporting system has on the proxy system, the long-term interests of companies and the desire

[65] GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972).

[66] Thomas, L. (October 22, 2018). Leveling the hunting fields. *Reuters Breakingviews*. Retrieved from https://www.breakingviews.com/features/guest-view-activist-wolves-at-the-window/

[67] Wachtell, Lipton, Rosen & Katz (March 7, 2011). *Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934*. Retrieved from SEC website: https://www.sec.gov/rules/petitions/2011/petn4-624.pdf

for companies to become and remain public, as part of its evaluation of the larger proxy system, we believe the Commission should consider reforms to this reporting system, including the following.

Reforms to Address the Undisclosed, Rapid Accumulation of Shares. As a result of advancements in technology, the 10-day filing period for Schedule 13D instituted in the 1960s has become outdated. Transactions that used to take days now take a matter of minutes. As other regulations have been updated to reflect the new reality, the 10-day period for Schedule 13D filings has remained unchanged for decades.[68]

Reports and studies indicate that the 10-day filing window currently allows activist investors to accumulate substantial positions in secret before disclosure is required.[69] This undisclosed buildup of ownership by a lead activist would be problematic on its own, but purchases by lead activists are frequently magnified by simultaneous purchases by other investors and hedge funds. Reports indicate that activists share their plans with other hedge funds and favored investors prior to disclosing the increase in their beneficial ownership.[70] These other investors who trade based on their knowledge of the activist's intentions (referred to as members of a "wolf pack") typically stand to profit when the lead activist's Schedule 13D is filed, as the filing of the Schedule 13D alone has been shown to increase a company's stock price by 6 to 8 percent.[71,72] However, these other investors are generally not required to aggregate their beneficial ownership with the lead activist for disclosure as a "group" under Section 13(d). As a result, the Schedule 13D filed by a lead activist frequently does not reflect the total stock ownership of a target company that is aligned with (and arguably beholden to) the lead activist.

The Commission has the authority and the means to fix this problem. Dodd-Frank specifically authorized the SEC to shorten the Schedule 13D filing window, and the Commission could clarify that wolf pack members should be required to disclose their beneficial ownership on

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[68] For instance, broker-dealer settlement periods were reduced to two days in 2017 and deadlines for other disclosure filings have been shortened: Form 8-K deadline cut from 15 calendar days to four business days in 2004; Section 16 filings are down to two business day deadlines; and Regulation FD imposes same-day disclosures on companies.

[69] Pulliam, S., Chung, J., Benoit, D., & Barry, R. (March 26, 2014). Activist Investors Often Leak Their Plans to a Favored Few. *The Wall Street Journal*. Retrieved from https://www.wsj.com/articles/activist-investors-often-leak-plans-to-peers-ahead-of-time-1395882780

[70] Wong, Y.T.F. (January 8, 2016). *Wolves at the Door: A Closer Look at Hedge Fund Activism* (Columbia Business School Research Paper No. 16-11). Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id =2721413

[71] Coffee, J.C. (January 25, 2016). Hedge Fund Activism: A Guide for the Perplexed [Blog post]. Retrieved from Columbia Law School website: http://clsbluesky.law.columbia.edu/2016/01/25/hedge-fund-activism-a-guide-for-the-perplexed/

[72] Brav, A., Jiang, W., Partnoy, F. & Thomas, R.S. (2008). Hedge Fund Activism, Corporate Governance and Firm Performance. *Journal of Finance.* Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id =948907

Schedule 13D.[73] Business Roundtable believes the filing window should be shortened to a period more consistent with current filing deadlines under other reporting requirements. In addition, the Commission should revise the Section 13(d) beneficial ownership definitions to make it clear that "group" includes members of a wolf pack.

Finally, to cut down on wolf pack formation during the period between crossing the 5 percent reporting threshold and filing the report, once the threshold is crossed, trading in the company's equity by the investor (or group of investors) beneficially owning more than 5 percent should be prohibited until the Schedule 13D filing is made. Such a change would align rules imposed on Schedule 13D filers with the 10-day cooling-off period currently imposed on investors when they switch from being passive Schedule 13G filers to Schedule 13D filers.[74]

Reforms to Address Hidden Ownership. Even once an activist is required to file a Schedule 13D, the filing may not fully reflect its true economic interest in the company. Beneficial ownership under Section 13(d) only picks up equity securities over which the investor has voting or investment control. As a result, there are a number of derivatives and non-traditional investments, such as cash-settled equity swaps, that fall outside the reporting obligations because the economic ownership is decoupled from investment and voting rights. The definition of beneficial ownership for purposes of Section 13(d) should be expanded to cover derivatives pursuant to which an investor does not technically control the voting or investment power but does stand to profit from the change in the value of the company's equity.

In addition to derivative and other investment disclosures that are not required to be made, there is currently a gap in the regulation of short sellers and those holding long positions. Since short positions are not required to be disclosed under Section 13(d), activist investors are able to use net short positions to secretly vote against company interests. Taking advantage of this gap enables a net short-selling investor to profit from losses on a company's shares — without required disclosure — while leveraging a smaller long position to influence a company's policies or corporate governance. The lack of disclosure of short positions blocks companies' view of trading in their securities and hampers effective communication with their investors. As a result, Business Roundtable believes the Commission should consider adding a requirement that activist investors must report a direct or indirect short investment position that represents more than 5 percent of a registered class of equity securities. In this instance, investors would not be permitted to use a net calculation of short and long positions.

Reforms to Provide More Effective Protections for Companies and Their Shareholders. Another problematic aspect of the current Section 13(d) reporting system is that companies do not have adequate options for redress when an investor has violated Section 13(d) disclosure rules and, therefore, are limited in helping protect their other shareholders. Currently, companies have a

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[73] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, §929R (2010).

[74] 17 C.F.R. §240.13d-1 (e)(2) (2018).

private right of action for injunctions, but once a lawsuit is filed, if the violating party takes corrective action (such as filing a new or updated Schedule 13D), the suit is generally made moot.[75] A main issue for companies in obtaining more relief is that courts have held that failure to file a timely Schedule 13D cannot, alone, establish irreparable injury sufficient to justify equitable relief.[76] Companies need more effective means to protect their shareholders from violations of Section 13(d) and to deter future violations. To that end, it would be beneficial to more readily provide companies with effective protections, such as sterilization of shares in connection with an investor's violation of Section 13(d).

Conclusion

The proxy system is as important as it is complex. The savings of America's workers and retirees — indeed, much of the world's workers — depend on the long-term success of publicly traded companies, as do the economic fates of their employees and trade partners. Because of the essential role the proxy system plays in setting the course of public companies, the proxy system should be continuously monitored and improved. Business Roundtable believes the recommendations discussed above have the potential to meaningfully increase the efficiency and accuracy of proxy voting, and to give companies better means to communicate with their ultimate owners.

Thank you for considering our comments and recommendations. We would be happy to discuss our concerns or any other matters that you believe would be helpful, at the upcoming Roundtable or in another venue. Please contact Maria Ghazal, Senior Vice President and Counsel of Business Roundtable, at [redacted] or [redacted].

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[75] Colombo, R.J. (2011). *Effectuating Disclosure Under the Williams Act*. Retrieved from https://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=1186&context=faculty_scholarship

[76] CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276 (2d Cir. 2011).