

November 13, 2018

Mr. Brent Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090



By e-mail: rule-comments@sec.gov

RE: File Number 4-725, SEC Staff Roundtable on the Proxy Process

Dear Sir:

Charles Schwab Investment Management (“CSIM”)¹ appreciates the opportunity to submit these comments for the record of the upcoming SEC Staff Roundtable on the Proxy Process. CSIM believes that a robust proxy process is a cornerstone of our capital markets system and strongly supports the Commission’s undertaking of a thorough review of that system to ensure that it continues to operate in a manner that best serves both shareholders and public companies.

In his statement announcing the staff roundtable,² Chairman Jay Clayton raised legitimate concerns about the relatively low rate of participation by retail shareholders and noted that one area the Commission plans to explore is “whether better communication and coordination among proxy participants, increased use of technology, changes to our rules, or investor education could increase participation.” CSIM welcomes that discussion and encourages the Commission to consider ways to improve the proxy system to engage more retail shareholders in the proxy process. However, the chairman added that “some have suggested that fund shareholders should have a means of providing input into how the fund adviser votes its portfolio securities.” CSIM has significant concerns about this idea, which is often known as “pass-through” voting. Those concerns are the focus of this letter.

Pass-through voting would be impractical

A single fund may be invested in hundreds or thousands of public companies, each with its own annual meeting that may include multiple items requiring votes. For example, the Schwab Total Stock Market Index Fund (SWTXS) has nearly 2,900 underlying securities and more than 185,000 fund shareholders. The Schwab US Broad Market ETF (SCHB) has more than 2,400

¹ Founded in 1989, CSIM, a subsidiary of The Charles Schwab Corporation, is one of the nation’s largest asset management companies, with more than \$360B in assets under management as of 09/30/18. It is among the country’s largest money market fund managers (based on assets under management). It is also the third-largest provider of index mutual funds and the fifth-largest provider of ETFs (Source: Strategic Insight as of 6/30/18; based on assets under management). More information about CSIM and the products it manages is available at schwabfunds.com.

² SEC Chairman Jay Clayton, “Statement Announcing SEC Staff Roundtable on the Proxy Process,” (July 30, 2018). Available at: <https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process>.

underlying securities and more than 490,000 shareholders. Last year, CSIM voted over 80,000 ballot items across its dozens of mutual funds and exchange-traded funds (“ETFs”). If CSIM was required to facilitate outreach to every shareholder on every proxy question put forward by every public company in a fund’s portfolio, it would be an overwhelming and prohibitively expensive task. But more critically, it would also overwhelm shareholders with a staggering amount of paper, electronic mail and phone calls, a process that could make the very act of investing in a fund a miserable experience and discourage participation in our capital markets.

Giving shareholders the opportunity to provide input on each agenda item would result in a massive outbound communication to shareholders, as well as present the operational issue of collecting their feedback and trying to communicate both investor views and the views of the portfolio manager to the proxy adviser who actually registers votes on behalf of CSIM. The challenges would be exacerbated by the fact that the vast majority of annual meetings by US public companies are held annually in a span of just a few months, usually March through July, which compresses this work into a narrow window each year.

Looking at this communication from the retail investor’s perspective, an investor holding 5 US equity mutual funds or ETFs on a broker-dealer platform which all held Apple common stock would receive 5 proxy communications, via either paper or email, at approximately the same time that would all look substantially identical. Then multiply the communications by every position held by each of those 5 funds, and compress the communications into a 5-month window: an investor could receive literally hundreds, perhaps thousands, of communications. The situation is even more complex for funds with international holdings. All of this is a recipe for even greater voter confusion, and likely much lower voting participation than current levels. Many retail investors buy mutual funds and ETFs to acquire diversified portfolios in a simplified manner; these multiple communications would severely undermine that goal.

The securities industry is already keenly aware of how difficult it is to get retail shareholders to participate in the proxy process. According to the Commission, only about 29% of shares in retail hands were voted during the 2017 proxy season.³ There is little reason to think that burying retail investors under dozens, hundreds, or even thousands of additional proxy communications is going to increase the participation rate.

Pass-through voting would be costly

As Investment Company Institute President and CEO Paul Schott Stevens noted in an October 2 commentary,⁴ the implementation of pass-through voting would require a number of steps, including identifying the shareholders of record; coordinating with intermediaries to verify the number of shares each underlying shareholder of an omnibus position holds for each underlying security; providing timely communications about the issues subject to the companies’ proxies, including passing along corporate proxy materials to each fund shareholder; and tracking and tabulating the shareholder feedback, among other tasks. Each of these steps has a basic cost;

³ Clayton statement, July 30, 2018.

⁴ ICI Viewpoint: “SEC Should Reject Complex, Costly ‘Pass-Through’ Proxy Voting,” (October 2, 2018). Available at https://www.ici.org/viewpoints/view_18_passthrough_voting.

those costs then increase if follow-up communications are required, particularly for ballot items that require a quorum. Examples from CSIM's own experience will illuminate this point.

In 2015, CSIM had a complex-wide proxy to elect trustees for its mutual funds and ETFs. Printing, mailing, solicitation, tabulation and other costs totaled \$4.85 million for 95 funds. This was a simple proxy because it was a trust-level vote and a routine item, which meant that broker-directed votes were permissible. As a result, the funds did not have to send any reminder mailings or perform any outbound solicitation calls to increase participation. It represents the minimum costs for simply getting information to the underlying fund shareholders.

In 2017, one of CSIM's funds, the Schwab Fundamental Global Real Estate Index Fund (SFREX), held a proxy vote to change the fee structure so that overall fees would be reduced. This is a small fund, which at the time had a little more than 9,000 shareholders and approximately \$93 million in assets. Such a proxy requires a majority of shareholders to cast ballots. CSIM was required to send multiple solicitation mailings, make outbound phone calls to shareholders and ultimately was forced to adjourn the meeting because a quorum had not been attained. A second round of solicitation was ultimately successful. The proxy was passed on the second vote with 50.45% of the shareholders participating – with 94% of votes cast in favor. The fund spent about 8 times more on the ballot measure than was spent on behalf of the same fund's shareholders during the complex-wide proxy question two years earlier. It is important to note that *this was a vote for shareholders to lower the fee they were paying to be invested in the fund*. Even on a question that was straight forward and so obviously a benefit to shareholders, it was extremely difficult to get shareholders to participate. Indeed, CSIM found through discussions with shareholders that some shareholders assumed the call was a sales pitch or even a “phishing” expedition; they actively refused to pick up the phone.

The example above is for a very small fund. Imagine the cost if this example was extrapolated to a fund with millions of individual investors, invested in hundreds of public companies. A broad index fund, as noted above, could be invested in thousands of underlying companies. By way of illustration, for the Schwab S&P 500 Index Fund (SWPPX), the cost from the 2015 complex-wide proxy to communicate with the fund's shareholders and set up the proxy voting apparatus on a routine, non-controversial measure was approximately \$260,000 to reach over 370,000 shareholders for a single ballot. If you multiply that cost by the 500 securities held by the fund, there is a cost of approximately \$130 million dollars to be paid. And who would pay those increased costs? Issuers and the broker-dealer community are already in an environment where the cost of delivering proxy materials is under intense scrutiny. If the funds must bear the expense, the cost would be passed on to shareholders in increased fees, impacting fund performance.

Even if a fund is required to communicate only once with its shareholders on a company's ballot, why would the response rate be any better than it is now from retail shareholders who own individual equities? Currently, the issuer gets a vote from a fund that will represent a much more significant holding than the majority of retail shareholders. Under this proposal it would either have to work with the fund to reach out to thousands of underlying shareholders to gain a quorum, or continue to rely on the funds' views and votes due to the lack of retail participation.

Pass-through voting would be contrary to shareholder interests

Proxy voting is a core service that CSIM provides its fund shareholders. As a leading asset manager, CSIM's fiduciary responsibility to shareholders includes using our proxy votes to encourage transparency and corporate governance structures that will promote or protect shareholder value. CSIM's Investment Stewardship team has decades of experience researching, analyzing and advising on proxy issues. CSIM also engages the research and voting services of independent proxy advisers. Significant resources are dedicated to understanding the complex issues that are subject to proxy voting. Shareholders that choose to invest in CSIM-advised funds expect us to use that expertise in their best interest. CSIM, like all managers of registered funds, provides full transparency in how we cast our votes, so every shareholder can see how we voted on their behalf on every issue.

Moreover, shareholders expect CSIM to keep fees as low as possible – it's another core element of the promise we make to our investors. But, as illustrated above, fees would rise if the expense of managing hundreds or thousands of proxies each year were added. Clearly, that is not in the best interest of shareholders.

For these reasons, CSIM urges the SEC to reject calls for "pass-through" proxy voting. The firm would welcome the opportunity to be part of the broader discussion of ways to increase proxy voting by retail investors of public companies. The Commission's 2010 Concept Release⁵ in this area provides a useful starting point for those discussions. But "improving" the proxy process by overwhelming shareholders with information and driving up the cost of investing in funds is no way to accomplish that goal.

Thank you very much for the opportunity to offer our perspective on this important issue. CSIM looks forward to the discussion at the November roundtable and would be happy to answer any questions or provide additional information that the Commission would find helpful as it considers next steps in its effort to improve proxy participation.

Sincerely,



Marie Chandoha
Chief Executive Officer, Charles Schwab Investment Management

⁵ Concept Release on the U.S. Proxy System, Releases Nos. 34-62495; IA-3052; IC-29340. 75 Fed. Reg. (July 22, 2010), at 42982,