



NATIONAL INVESTOR RELATIONS INSTITUTE

November 13, 2018

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

Subject: File No. 4-725, SEC Staff Roundtable on the Proxy Process

Dear Mr. Fields:

The National Investor Relations Institute (“NIRI”) appreciates the opportunity to provide comments to the Securities and Exchange Commission (“SEC”), regarding its upcoming Roundtable on the Proxy Process, to be held on November 15, 2018.

Founded in 1969, NIRI is the professional association of corporate officers and investor relations consultants responsible for communication among corporate management, shareholders, securities analysts, and other financial community constituents. The largest professional investor relations association in the world, NIRI’s more than 3,300 members represent over 1,600 publicly held companies and \$9 trillion in stock market capitalization.

In July 2009, the SEC announced that it would be conducting a staff-led study of the U.S. proxy process,<sup>1</sup> and the Commission issued a wide-ranging and comprehensive Concept Release on the U.S. Proxy System in July 2010.<sup>2</sup> More than 300 comments were submitted in response to the Concept Release, with the substantial majority of commenters urging the SEC to move forward to update its rules and modernize the proxy process.

The many problems that exist in the current proxy process were presented and discussed in the Concept Release and many proxy participants would agree that the issues identified in the Release still require SEC action. This comment letter will not review again these problems and issues. Instead, NIRI will present its suggestions for regulatory action on two of the most

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<sup>1</sup> See Mary L. Schapiro, Chairman, Securities and Exchange Commission, Statement at SEC Open Meeting (July 1, 2009).

<sup>2</sup> Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42, 982 (July 22, 2010) (hereinafter “SEC Concept Release”).

significant issues in the proxy process: (1) appropriate oversight of proxy advisory firms; and (2) proposed reforms to the proxy voting and shareholder communications system.<sup>3</sup>

### Oversight of Proxy Advisory Firms

For more than eight (8) years, NIRI has urged the SEC to develop a uniform regulatory framework for proxy advisory firms, so that the SEC and the institutional clients of these firms could engage in more robust oversight of their activities and business practices.<sup>4</sup>

NIRI supports the passage of H.R. 4015, legislation sponsored by Representatives Sean Duffy (R-WI) and Gregory Meeks (D-NY) to establish a uniform regulatory framework for proxy advisory firms.<sup>5</sup> H.R. 4015 would require each proxy advisory firm to register with the SEC and comply with certain requirements to (1) improve the transparency of the activities engaged in by these firms; and (2) properly regulate certain business practices engaged in by one or more of these firms.

The SEC does not need to wait until this legislation is enacted, as the Commission already has authority to act through an existing exemption from its proxy solicitation rules applicable to proxy advisory firms.<sup>6</sup> This Rule exempts proxy advisory firms from complying with solicitation and disclosure rules that apply to other proxy participants, as long as certain conditions are met.<sup>7</sup>

The SEC has the authority to expand the list of conditions in this Rule to address issues that have been raised involving the current activities and business practices of proxy advisory firms. At a minimum, the SEC should consider adding the following new conditions to the existing exemption:

1. Conflicts of Interest. A new condition should require proxy advisory firms to establish, maintain, and enforce written policies and procedures to disclose, mitigate, and eliminate conflicts of interest.

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<sup>3</sup> Regarding the third major topic (shareholder proposals) to be considered during the Roundtable, NIRI agrees with the National Association of Manufacturers and other commenters that the SEC should raise the resubmission thresholds in Exchange Act Rule 14a-8(i)(12), and NIRI supports the specific thresholds (6, 15, and 30 percent) that the Commission proposed in 1997.

<sup>4</sup> NIRI appreciates the SEC's issuance of Staff Legal Bulletin 20 in 2014 and the recent withdrawal of two no-action letters relating to the use of proxy advisory firms by investment advisers.

<sup>5</sup> H.R. 4015, the Corporate Governance Reform and Transparency Act, passed the House of Representatives on December 20, 2017, and is pending in the Senate Banking Committee. A hearing on the bill was held in the Banking Committee on June 28, 2018.

<sup>6</sup> See 17 C.F.R. § 240.14a-2(b)(3).

<sup>7</sup> As an example, the proxy solicitation exemption permits proxy advisory firms to decline to make their reports publicly available, unlike public company proxy materials.

2. Code of Conduct. A new condition should require proxy advisory firms to establish, maintain, and enforce a written code of ethics and professional conduct.
3. Internal Controls. A new condition should require proxy advisory firms to establish, maintain, and enforce an effective internal control structure, regarding the policies, procedures, guidelines, and methodologies used to develop proxy voting recommendations.
4. Public Transparency. A new condition should require proxy advisory firms to provide for website disclosure of the policies, procedures, guidelines and methodologies used by each firm. Each proxy advisory firm should also make available on its website without charge a copy of each report that contains a proxy voting recommendation about a public company, no later than ninety (90) days after the shareholder meeting to which the voting recommendation relates.
5. Company Reports. A new condition should require proxy advisory firms to provide each public company (that requests such a review) with an advance copy—at least three (3) business days before issuance—of any report that includes a proxy voting recommendation about such company.<sup>8</sup> This advance disclosure would permit the company to review and comment on: (a) the factual accuracy of statements made in the report, and (b) the methodologies and assumptions used to develop any recommendations in the report.
6. Factual Errors. A new condition should require proxy advisory firms to promptly correct any factual or other error in a report that is identified by a public company. The firms should disclose when comments have been received by a public company on the front page of a report about that company, with a hyperlink provided for investors to access such comments. This process would ensure that investors don't vote based on inaccurate information or a flawed assumption by the proxy advisor.

Proxy advisory firms should also be required to (1) maintain records; (2) file annual or other reports required by the SEC; and (3) comply with any other conditions, limitations, or requirements that the SEC deems to be in the public interest and for the protection of investors. Additionally, the SEC should examine proxy advisory firms regularly to ensure compliance with these recommended conditions.

To improve the oversight of proxy advisory firms by their institutional clients, the SEC should also consider amending Staff Legal Bulletin 20 to expand its requirements.<sup>9</sup> At the very least, the amended guidance should:

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<sup>8</sup> To reduce the burden of this new condition, the SEC could use its discretion to allow the proxy advisory firms to implement the draft review process gradually (*e.g.*, S&P 500 companies in year one; S&P 1500 companies in year two; and Russell 3000 companies in year three).

<sup>9</sup> SEC Staff Legal Bulletin 20, Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms (June 30, 2014).

- Require registered investment advisers to publicly disclose on at least an annual basis: (a) the engagement by an adviser of a proxy advisory firm by name in connection with the voting of securities; and (b) the adviser's policies and procedures for oversight of the voting recommendations provided by each proxy advisory firm engaged for this purpose;
- Require each registered investment adviser to ensure that its voting decisions with respect to client securities are in the best interests of its clients, shareholders, and beneficiaries; and
- Require each registered investment adviser to ensure that it is exercising appropriate oversight over its voting decisions with respect to client securities, including through the use of a process or procedure by which the investment adviser is responsible for expressly authorizing and directing its voting decisions for each individual ballot prepared by a proxy advisory firm.<sup>10 11</sup>

#### Proposed Reforms to the Proxy Voting and Shareholder Communications System

The U.S. proxy system is complicated and multi-faceted, involving several layers of intermediaries who are not the economic owners of corporate shares. This increases the complexity and cost of processing proxy materials and soliciting votes. It also makes it very difficult for companies to know who their shareholders are and to communicate with them in an effective manner.

The proxy system and the SEC's rules were developed when most annual meetings were routine, and few matters were contested. This system has not kept pace with the development of back office systems used in the securities industry, significant advances in the use and availability of communications technologies, and the growth of the Internet. Similarly, corporate governance regulation and practices have changed significantly over the past several decades, which has increased the importance of investor-issuer engagement.<sup>12</sup>

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<sup>10</sup> A proxy advisory firm should not be permitted to offer a voting service that allows a client to establish, in advance of receiving proxy materials for a particular shareholder meeting, general guidelines or policies that the proxy advisory firm is then authorized or permitted to apply for the purpose of making and executing voting decisions on behalf of the client. Investment advisers should not be permitted to "outsource" their voting decisions in this manner.

<sup>11</sup> In a 2017 comment letter, NIRI raised concerns about the use of automated voting systems by proxy advisor clients and questioned whether the automated casting of votes without any affirmative action by investment advisers was consistent with Staff Legal Bulletin 20. *See* NIRI, Letter to SEC Chair Jay Clayton re: Proxy Advisory Firms – Shareholder Voting Practices, August 3, 2017. Unfortunately, the use of such automated voting procedures appears to be widespread. According to the American Council for Capital Formation ("ACCF"), 82 asset managers (with more than \$1.3 trillion in assets under management) are voting with Institutional Shareholder Services more than 99 percent of the time. *See* ACCF, "The Realities of Robo-Voting," November 9, 2018.

<sup>12</sup> Within the past 15 years, there has been significant growth in hedge fund activism, which has prompted companies to devote more time to communicating with their long-term shareholders. Since 2011, most U.S.

These changes have accelerated the need for companies to communicate more frequently, and on a more time-sensitive basis, with their shareholders. However, this is difficult to accomplish under the current proxy system, which is controlled by brokers, banks, and their agents, and which classifies beneficial owners as either Objecting Beneficial Owners (“OBOs”) or Non-Objecting Beneficial Owners (“NOBOs”). Public companies are not permitted to communicate with OBOs; and communication with NOBOs is expensive and very restricted.

A related problem with the proxy system involves the beneficial owner voting process. As noted by the SEC in its 2010 Concept Release, “no one individual participant in the voting process ... possesses all of the information necessary to confirm whether a particular beneficial owner’s vote has been timely received and accurately recorded.”<sup>13</sup> One aspect of the problem results from the fact that beneficial owner voting instructions and registered shareholder proxies are collected and tabulated separately.

Securities lending transactions and a failure to deliver securities by settlement date also are preventing the development of a list of beneficial owners eligible to vote as of the record date for a shareholder meeting. Within the street name system, a list of eligible voters can only be developed by requiring each financial intermediary holding corporate shares to reconcile its long positions with its share lending positions (and failure to deliver positions) before a proxy mailing takes place. This would ensure that proxy materials and voting cards are only sent to customer positions authorized to vote in a shareholder meeting.

To address these problems and issues, the SEC should consider the following recommendations to update its rules and reform the proxy process system:

1. NOBO and OBO Classification. Public companies should have access to contact information for all of their beneficial owners and should be permitted to communicate with them directly. The NOBO and OBO classification for beneficial owners should be eliminated.

Those beneficial owners wishing to remain anonymous should be permitted to register their shares in a nominee account with their broker, bank, or other third-party intermediary. Those who are currently classified as OBOs should have adequate notice of the elimination of their OBO status, to permit them to decide whether to establish a nominee account.

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companies have been required to hold non-binding “Say on Pay” votes, which have led to more requests by investors for regular engagement.

<sup>13</sup> SEC Concept Release at 42,992.

Communications with beneficial owners should only be for purposes involving the corporate or business affairs of a company. Federal privacy regulations should apply to the use of beneficial owner information received from a broker or bank.<sup>14</sup>

2. Beneficial Owner List Compilation. The lists of beneficial owners used for shareholder meetings and other communications purposes should be compiled and maintained by a data aggregator or central intermediary performing this service for all financial intermediaries holding corporate shares.

An individual public company (or shareholder) requiring a copy of its beneficial owner list would obtain access to this list in a manner similar to how a company or a shareholder currently accesses its NOBO list.

The data aggregator would obtain beneficial owner contact information from all brokers, banks, and other intermediaries; however, no information about any intermediary relationship with a customer would be provided to a public company or its service provider(s). In other words, as is the case today, the names of brokers and other intermediaries with whom the beneficial owners maintained their accounts would not be disclosed.

Access to beneficial owner lists would be non-discriminatory. Both a company and its shareholders seeking to communicate with beneficial owners would have equal access to the beneficial owner list. As noted above, beneficial owner lists should only be used for communications involving the corporate or business affairs of a company.

3. Competition Among Proxy Service Providers. As noted above, the current functions of (a) beneficial owner data aggregation; and (b) proxy communications distribution would be separated, providing a public company with the opportunity to select a proxy distribution provider of its own choosing. The proxy distributor should be responsible for transmitting the proxy statement and proxy cards to all shareholders, once the beneficial owner list is obtained from the entity serving as the data aggregator.<sup>15</sup>
4. Beneficial Owner Proxy Authority. Proxy voting authority should be transferred to each beneficial owner, as of the record date established for a shareholder meeting, through the same omnibus proxy process that is currently employed by DTC.<sup>16</sup>

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<sup>14</sup> SEC regulations permit the disclosure of information: (a) “necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes”; or (b) “[t]o comply with federal . . . laws.” See 17 C.F.R. § 248.14(a), 17 C.F.R. § 248.14(b)(2), and 17 C.F.R. § 248.15(a)(7)(i). Similar privacy provisions apply to banks.

<sup>15</sup> For public companies using the Notice and Access format, a proxy card would be mailed with each Notice of Internet Availability of Proxy Materials, to encourage voting participation by retail investors.

<sup>16</sup> Beneficial owners receiving proxy materials from a public company directly would receive a proxy card, instead of a Voting Instruction Form (“VIF”). Individual beneficial owners would be free to transfer their proxy authority to a third-party, through a client-directed voting agreement or similar arrangement.

A transfer of proxy authority to the beneficial owner level eliminates the need for broker discretionary voting under New York Stock Exchange (“NYSE”) Rule 452.<sup>17</sup> However, additional steps should be taken to ensure that the loss of broker discretionary voting does not harm the ability of any public company, especially a small or mid-cap issuer, to obtain a quorum at a shareholder meeting.

To address this concern, conditional language should be added to the omnibus proxy instrument to authorize DTC, or another depository institution, to vote the shares of any unreturned proxies as “present,” for the limited purpose of establishing a quorum for the shareholder meeting.<sup>18</sup>

5. Proxy Vote Counting and Tabulation. Proxy votes should continue to be counted and tabulated using the current practices governed by state law, including, when necessary, the services of an independent inspector of elections.
6. Integrity of Proxy Voting Process. The proxy voting process should be fully transparent and verifiable, starting with the compilation of a reconciled list of beneficial owners eligible to vote and ending with the final tabulation of votes cast at a shareholder meeting.

Brokers and other financial intermediaries engaged in share lending (or with “failure to deliver” positions) should be required to reconcile their share positions as of the record date for each shareholder meeting. This reconciliation should occur before an intermediary transmits record date beneficial owner information to the data aggregator discussed above and before proxy forms are mailed to beneficial owners and registered shareholders. All record date positions maintained by financial intermediaries should be reconciled early in the voting process, to avoid distributing proxies to ineligible shareholders and to avoid discrepancies in tabulating final vote counts.<sup>19</sup>

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<sup>17</sup> If this recommendation is adopted, there would no longer be any broker discretionary voting pursuant to NYSE Rule 452, which currently permits brokers to vote uninstructed shares on routine matters at a shareholder meeting. Other nominees, such as banks, are not permitted to vote uninstructed shares at a shareholder meeting.

<sup>18</sup> This recommendation is consistent with existing SEC rules. See 17 C.F.R. § 240.14a-4(b)(1) (“A proxy may confer discretionary authority with respect to matters as to which a choice is not specified by the security holder provided that the form of proxy states in bold-face how it is intended to vote the shares represented by the proxy in each such case.”).

<sup>19</sup> This proposed process would be facilitated by a recent amendment to the Delaware General Corporation Law permitting a board of directors to fix one record date for shareholders entitled to notice of a meeting and a separate record date for determining the shareholders entitled to vote at such a meeting. This amendment should help a company better align the economic and voting interests of its shareholders and reduce the risk of having investors with voting rights but no share ownership as of the date of the shareholder meeting. This process also could be facilitated through the use of distributed ledger technology, which was authorized by statute in 2017 for public companies registered in Delaware.

The vote counts on matters before a shareholder meeting should be auditable and capable of third-party verification, so that a validation of the final tabulation of the votes of both registered and beneficial owners can occur.

7. Investor Education. Before a new proxy voting and communications system is implemented, a national investor education campaign should be launched to explain the proxy voting process and to encourage individual investors to vote their proxies at shareholder meetings. Survey research indicates that the substantial majority of individual investors do not understand the workings of the proxy system.

Please feel free to contact us at NIRI if you need additional information or are interested in discussing these issues further. Thank you for your consideration of our views on this matter.

Sincerely,



Gary A. LaBranche, FASAE, CAE  
President and CEO  
National Investor Relations Institute

cc: The Honorable Jay Clayton  
The Honorable, Kara M. Stein  
The Honorable Robert J. Jackson, Jr.  
The Honorable Hester M. Peirce  
The Honorable Elad L. Roisman  
William Hinman, Director, Division of Corporation Finance  
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