



11th November 2018

Brent J. Fields,
Secretary, Securities and Exchange Commission,
100 F Street, NE,
Washington, D.C.
20549-1090
United States of America

Dear Mr Fields;

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

Minerva Analytics Ltd (Minerva) is pleased to be able to contribute to the Securities and Exchange Commission's (SEC) important work on safeguarding shareholder rights and improving market efficiency.

The SEC round table comes at a critical time for financial markets. Ten years after the Global Financial Crisis, US financial services has suffered a 20-point decline according to the highly respected Edelman Trust Barometer¹. We share the belief of many investors, corporations, national and international regulators, that a modern, hygienic system of governance and vote plumbing is a critical component of a trusted financial market. Without doubt, one of the most pressing questions of the day is this: "How can corporations and providers of capital work together to re-establish trust in business and ensure the long-term sustainability of our environment, create well-paid jobs, and keep our pension promises?"

We believe that good governance and informed voting supports long-term risk adjusted returns for all types of investors, institutional or retail. To that end. Minerva's purpose is to help asset owners and managers exercise their ownership rights with independent and objective research on the governance of global corporations. This research is combined with a secure vote administration platform which transmits clients' encrypted voting instructions directly to the official meeting tabulator. Wherever possible Minerva uses open ISO-format messages that our organisation has developed in conjunction with registrars (stock transfer agents) and SWIFT since the late 1990s.

The agenda for the SEC Roundtable is ambitious and we do not under-estimate the complexity of the issues that the Staff and Commissioners are addressing. In the enclosed memorandum we share some insights that we have developed over the past twenty years of operation in this industry. We would like to preface those longer remarks with a brief summary:

¹ <https://www.edelman.com/research/trust-in-financial-services-2018>

- We note the activities of the immensely vocal, but narrow, anti-ESG and governance lobby which continues to ignore and disrespect the beliefs and preferences of capital providers. Investors use governance research and vote execution services to legitimately help protect their interests and support long-term capital formation.
- The very well-funded and ideologically-fixated lobby is intent on diverting the SEC from the major **structural inefficiencies in the vote plumbing** (execution). If they were to succeed, it would be immensely damaging for corporations and investors, both institutional or retail. As you will hear during testimony from others in the industry, the US proxy plumbing system lags global peers and is no more fit for purpose than it was when the original concept release was published in 2010². We urge the SEC not to stray from the critical task of improving the system for all stakeholders.
- **The problems of plumbing** are not those of by either technology or standards. Rather they are a function of legacy regulations, systems and procedures which have resulted in anti-competitive business models. There is extensive and consistent evidence from international markets which shows that firms whose profitability is entirely dependent on such archaic systems are at the root of nearly all the plumbing blockages.
- The “power and dominance” issues raised in respect of proxy service vendors (be they research or distribution firms), are more properly anti-trust/anti-competition issues. The market for proxy services is severely constrained, to a much greater extent than either audit or credit ratings, and barriers to entry are high. Regulations which further inhibit competition and innovation need to be carefully considered for their foreclosure effect. While regulatory action may be aimed at US actors, it will have an extra-territorial effect due to the globalised nature of financial markets. As we have seen with earlier proxy regulation, the laws of unintended consequences are difficult to repeal.
- The anti-ESG and governance lobby is attempting to impose onerous regulation on analysts based on “evidence” that is poorly researched, non-peer reviewed, deeply conflicted, lacks funding transparency and invariably wrong in fact and substance. Their attempts represent an unnecessary, unjustified, discriminatory and unconstitutional attack on the market for ideas. If allowed to succeed they would create information asymmetries for investors that could only be described as totalitarian speech by corporations.
- No problem can be effectively solved without clear definitions and agreed understanding of stakeholder needs. Based on our experiences with other global regulators who have also investigated proxy plumbing, agreed definitions will be critical to effective regulation and systems development.

² <https://www.sec.gov/rules/concept/2010/34-62495.pdf>

The problems of US proxy plumbing are not confined to domestic US shareholders. A substantial proportion of US securities are owned by international shareholders either directly or through ADRs. **US proxy plumbing is therefore a global concern.** Although Minerva is based in the UK, its clients hold substantial blocks of US securities and experience considerable difficulties with exercising their ownership rights. Additionally, many international asset managers have either US parents or affiliates which inevitably shapes local market conduct and business practices. Regulations developed in the US will therefore have a direct impact in overseas markets and by extension non-US governance service providers.

Thank you again for this opportunity to offer some thoughts on possible solutions for **fixing the proxy plumbing**. We would be happy to provide further background and share our insights either via written submission or teleconference.

Yours sincerely

J Sarah Wilson

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Chief Executive

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

Comments prepared by:
Minerva Analytics Ltd
November 2018

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1 Introduction

These comments have been prepared by Minerva Analytics Ltd in response to a call for evidence from the Honorable Jay Clayton, Chairman of the US Securities and Exchange Commission.

We are grateful for this opportunity to share our experience of the detailed workings of the “proxy plumbing” and the problems associated with a system which is, by any measure of operational efficiency, no longer fit for purpose.

The call for evidence states that an accurate, transparent and efficient proxy system can inspire confidence for many stakeholders. **We completely agree.** It is for these reasons that we wish to participate in the debate and, where possible, make a positive contribution to ensuring that the US share ownership system receives the regulatory attention that is both deserved and required.

As the call for evidence outlines, there are many pressing, complex and inter-twined issues considered. We are also acutely conscious that the call for evidence has stirred an extraordinary level of lobbying. Substantial sums are currently being spent on social and mainstream media to (mis)direct the debate towards one narrow area – the role of so-called proxy “advisors”. We believe that delays to reform would be expensive for both investors AND corporations. We therefore urge that both SEC staff and Commissioners remain focussed on the critical priority of **fixing the broken plumbing** i.e. the execution, which undermines the integrity of an important democratic process.

1.1 About Minerva

Minerva Analytics Ltd is a UK-based proxy services company which, through its subsidiary The Manifest Voting Agency Ltd (established 1995) enables investors to vote their shares using state of the art technology and information systems. In addition to a secure and confidential voting platform, which fully supports end to end vote confirmations and open message standards and encryption, Minerva provides independent and objective research on governance, executive pay and sustainability factors in respect of global securities, including North American corporations.

Although our clients are based in the UK and Continental Europe, their portfolio securities are global; many have up to 40% exposure to North American securities. North America has been part of our core coverage since 2011 when our former US partner, ProxyGovernance Inc, was sold to Ernst& Young. During the 2018 AGM season Minerva provided research on more than 600 US securities from a universe of 6,500 global securities in coverage.

1.2 Partnerships

Minerva works in close partnership with ECGS Ltd, a consortium of independent European governance service providers which comprises Proxinvest (France), Frontis (Italy), Corporance (Spain), DSW (Germany) and Ethos (Switzerland). Our partners do provide voting recommendations based on a collective ECGS policy. We are members of the

International Corporate Governance Network (ICGN), the Pensions & Lifetime Savings Association (PLSA).

Minerva's data is not only used by investors. It is a unique data set which traces the development of international governance over nearly a quarter of a century. It is used by many leading academic institutions including Wharton, London Business School, London School of Economics, Universities of Sheffield, Edinburgh and many others whose research appears in high-quality peer-reviewed journals.

In the regulatory context, Minerva has provided considerable technical evidence to SWIFT, ESMA, the European Commission, the Canadian Securities Authorities, the OECD the UK Parliament, UK Department of Business, Treasury, Work and Pensions on various aspects of corporate governance and shareholder voting with a view to improving governance and cross-border voting for all types of investors.

1.3 Code of Conduct

Both Minerva and Proxinvest are founding signatories of the Best Practice Principles for Shareholder Voting Research.³ The BPP Group was formed in February 2013 following an in-depth review of the proxy research industry by ESMA, the European Securities & Markets Authority. After a comprehensive public consultation procedure, ESMA determined that there had been no market failure in respect of the proxy advisors. However, they did identify a need for a deeper understanding of the varied role of proxy advisors which could be achieved through greater transparency. Therefore, following ESMA's 19 February 2013 statement,⁴ the BPP Group (BPPG) was formed.

An independent Chair of the group was appointed to guide the process, Prof. Dr. Dirk Andreas Zetsche, LL.M. (Toronto), Propter Homines Chair for Banking and Securities Law, University of Liechtenstein (Principality of Liechtenstein), and Director of the Center for Business & Corporate Law, Faculty of Law, University of Duesseldorf (Germany)⁵. After publication of the Principles, Professor Zetsche produced an independent report which explained the workings of the BPPG, the public consultation and subsequent publication of Principles.⁶ Although the Principles originated in Europe, there are no geographical barriers to participation.

Consistent with the undertakings given by the BPP Group to revisit the Principles after two full years of operation, Minerva and Proxinvest are actively involved in a review which has involved a global public consultation. The review is expected to conclude its work during 2019. Any stakeholder who wishes to can communicate directly with the group through the collective email address of committee@bppgrp.info or chairman@bppgrp.info

³ <https://bppgrp.info>

⁴ <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-240.pdf>

⁵ https://www.wen.uni.lu/formations/fdef/certificate_in_law_and_regulation_of_inclusive_finance/dirk_andreas_zetsche

⁶ <https://bppgrp.info/wp-content/uploads/2013/10/Report-of-Chairman.pdf>

For the avoidance of doubt, the comments in this memo are entirely our own and independent of the BPPG.

As the SEC may be aware, Article 3j of the European Shareholder Rights Directive requires that proxy advisors are required to adhere to a code of conduct.⁷ The Directive is currently in the process of transposition in Member States, including the United Kingdom.

1.4 Global impact of the US Proxy System

Global regulations and good practice standards increasingly require investors to have clearly stated policies in relation to environmental, social and corporate governance (ESG) issues and climate change. Shareholder voting is one of the ways by which they can express those views to corporations as part of a well-rounded stewardship program. Asset Owner membership of the Principles of Responsible Investment now stands at 373 funds representing U\$19.1 trillion. Many countries now require consideration of ES & G issues and have developed nationally recognised governance or stewardship codes⁸ which sit alongside supra-national standards such as the G20/OECD Principles of Corporate Governance⁹

The US stock market is conservatively estimated to represent 60% of the value of all shares traded world-wide. In February 2018, the US Treasury determined that the value of foreign holdings of US securities stood at \$18,436 billion, of which \$7,189 billion were held in U.S. equities. Shareholders from the United Kingdom are the second largest holders of US securities standing at \$844 billion.¹⁰ Although equity allocations are smaller than they were a decade ago, UK investors typically allocate 62% of their equity holdings to non-domestic equities, the bulk of which will be in developed markets.¹¹ Some funds may allocate as much as 20% of their long-term investments to North American equities compared with 12% in UK ones. With so much retirement security at stake, it is not surprising that the governance of US corporations is of material interest to international investors.

⁷ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017L0828&from=en>

⁸ <https://sway.com/tDCd1K9NpuuL6Dvs>

⁹ <http://www.oecd.org/corporate/principles-corporate-governance.htm>

¹⁰ <https://home.treasury.gov/news/press-releases/sm0374>

¹¹ [Mercer European Asset Allocation Survey 2018](#)

2 The SEC Staff Roundtable Issues

Chairman Clayton has outlined a number of critical issues which revisit many of the topics raised by the 2010 Proxy Plumbing Concept Release.¹² Although almost a decade has passed, many of the intractable issues outlined in the Concept Release remain unchanged. Arguably many are worse.

The SEC has set an ambitious agenda covering six broad themes:

<u>The Voting Process</u>	<u>Proxy Advisory Firms</u>
Over- and Empty Voting	Delegation and dependence
Execution, tabulation and confirmation	Market structure and competition issues
Beneficial owner transparency	Issuer participation
	Policies and procedures
	Conflicts of interest
	Regulatory regime, if any
<u>Retail Shareholder Participation</u>	<u>Technology & Innovation</u>
Encouraging retail participation	Role for new technology, if any
Role of pooled investment vehicles	
<u>Shareholder Proposals</u>	<u>Other Commission Action</u>
Ownership Thresholds	Universal proxy cards
Re-submission	Binding vs advisory votes
Beneficial Owner participation	ESG disclosure standards

2.1 The Voting Process

We agree that shareholder voting processes should inspire confidence. It should be confidential, secure, timely and efficient. Sadly, it is not. There is considerable data leakage and inappropriate monetization of inefficiency, generally without the knowledge or consent of beneficial owners. These inefficiencies harm both investors and issuers leading to widespread distrust and excessive costs. The reasons for the inefficiency are a mixture of monopoly power abuse compounded by regulatory capture. And for the avoidance of doubt – not by proxy advisors.

The systematic inefficiencies have been well documented by the academic community^{13 14} and were discussed at some length during the SEC's work in 2010.

We urge the Commission to **focus its attention on the significant deficiencies in the proxy plumbing**. The European Commission, through the Shareholder Rights Directive¹⁵ and associated implementing regulations¹⁶ provide useful pointers for consideration. However, unless the underlying structural problems of the clearing and settlement system are

¹² <http://www.sec.gov/rules/concept/2010/34-62495.pdf>

¹³ Eva Micheler [Custody Chains and Remoteness: Disconnecting Investors from Issuers](#) 2014

¹⁴ Source: David Donald [Heart of Darkness: The Problem at the Core of the US Proxy System and Its Solution](#) 2010

¹⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017L0828>

¹⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1212&from=EN>

addressed it will be difficult to make real progress. In this regard the US Stock Transfer Agents will offer powerful evidence of the way the system short-changes corporations and investors alike.

2.2 Retail Shareholder Participation

The lack of retail shareholder participation is not surprising given the arcane and archaic infrastructure of securities ownership. However, adding a note of caution, the lobby which seeks to encourage passive retail participation is doing so in the hope that this will diminish the influence of institutional investors who, in the eyes of some, are unduly influenced by proxy advisors and make “erroneous decisions”.

We agree that retail investors should be enfranchised – they should be given their full property rights, as should pension funds or other types of investors. Proxy advisors are in this regard fully aligned with retail investors.

2.3 Technology & Innovation

We agree that technology and innovation can help resolve many of the operational difficulties experienced in the proxy plumbing. For over 20 years Minerva has demonstrated that technology and innovation, in partnership with open-access and open-standards can make a significant material difference. We have enabled clients to have more time to make considered decisions by reducing vote cut-off times, increased confidence in assurance of lodgement with time-stamps for delivery. However, at the same time we have seen how anti-competitive behaviour can stop “client first” innovation in its tracks.

Open standards, open access and inter-operability have been the primary drivers of the internet and electronic banking revolution. Proxy voting is, by contrast appears to be stuck in an age of quill pen and parchment.

Distributed ledger technology (DLT or Blockchain) appears to hold some opportunities for improving operational efficiency. However innovative the technology, without a supportive legal infrastructure its promise will remain unfulfilled. Therefore, there are some first principles that need to be addressed, specifically the interface between trading and settlement which is built around securities regulations and the post-trade environment which is almost entirely dependent on corporation law and property rights. Until issues of inter-operability and standards are agreed, a great deal of time and effort will be wasted. The proxy plumbing needs fixing now, not in another 10 years’ time.

With this in mind, there are immediate improvements that can be made within the existing infrastructure.

1. Vote plumbing problems can be boiled down to cumbersome notification processes, tortuous and duplicative transmission of instructions, lack of confidentiality and process monopolization by a few powerful intermediaries. In IT terms it is a problem of GIGO “garbage in, garbage out”. There are market participants who have the knowledge, skills and motivation to solve these problems, but they are held back by

vested interests and regulations which are now out of step with modern business operations.

2. Corporations and their shareholders should be able to directly communicate with each other. Legal Entity Identifiers¹⁷ (LEI) will support direct communication this process. Bring Legal Entity Identifiers into the proxy system so that each shareholder can be uniquely identified anywhere within the system will benefit retail investors as well as institutions. At the same time, the SEC should transfer responsibility for provision of beneficial owner data to DTC so that any duly authorised party can offer competitive proxy distribution services for corporations.
3. The CEDE & Co Omnibus Account creates unnecessary complexity and should be revisited as part of a holistic overhaul of the system. In the meantime, the DTC should assume responsibility for distribution of data in relation to beneficial owners, such data to be provided in common file formats open to all participants. We believe that this will rapidly reduce costs for corporations and improve efficiency. Very importantly, this would open the gates for competition choice for consumers who can then select from a variety of voting platforms to communicate directly and securely with their investee companies.
4. Eliminate the OBO/NOBO status to improve operational efficiency for all market participants and reduce costs overall. Additionally, it but would support the US commitment to meet the G8 core principles around transparency of ownership and control of corporations.¹⁸
5. Clarify that any duly authorised party can transmit voting instructions back to the tabulator rather than being forced to send it back through a complex chain of intermediaries.
6. Move voting onto a T+2 or V+2 footing – by which we mean that record dates should be set as close to the meeting date as possible. Forty-eight hours would bring the US into line with other global markets.
7. We do not agree that mandatory voting or standing instructions will benefit anyone, except perhaps intermediaries who earn volume-related processing fees. Bearing in mind the criticisms levelled against institutional investors for their “empty voting” why would we wish to see the same possibility being created for another segment of the market?
8. Fee transparency is a critical component of trust in the financial system. We would encourage the SEC undertakes a comprehensive forensic audit of all fees, charges and rebates in the proxy system to determine where the money is flowing and where the conflicts of interest may arise. Bearing in mind that one participant in the system has revenues in the region of \$4 billion there is clearly a lot at stake.

¹⁷ <https://www.financialresearch.gov/data/legal-entity-identifier/>

¹⁸ <https://star.worldbank.org/about-us/transparency-beneficial-ownership-resource-center>

9. Hybrid/Virtual Shareholder meetings require further investigation and clear regulation. We do not support the elimination of face to face shareholder meetings as it diminishes the central concept of accountability inherent in the voting process.
10. The SEC should bring all proxy regulation under its umbrella rather than leaving it to stock exchanges. This would spur competition, reduce conflicts of interest and encourage a more inclusive stakeholder-driven approach to appropriate regulation which is sensitive to all participants needs.

2.4 Shareholder Proposals

Shareholder resolutions are an important democratic safety valve which allow shareholders to communicate directly and publicly with their investee companies on a variety of important topics. In recent years many of the resolutions have addressed significant deficits in corporate reporting or governance standards which are taken for granted elsewhere in the world. This is particularly true for issues such as climate change reporting, where US corporations lag significantly. These are not political or social resolutions, they address questions of risk and return.

We do not believe that the shareholder proposal system is fundamentally broken, rather it is a symptom of problems elsewhere in corporate governance and reporting. Arguably, if corporate advisors spent as much time and money on bringing disclosures up to international standards rather than fighting shareholder resolutions, the volume of shareholder resolutions would naturally recede in response to the improved disclosure quality.

The US is unusual in having a securities regulator be the primary arbiter of what is allowed on a proxy ballot. This must create an administrative cost and burden for the SEC.

One possible solution would be for radical re-regulation which puts matters directly into the hands of shareholders and corporations to work through their misunderstandings. This would be a significant improvement upon the ad-hoc mixture of stock exchanges, trade associations and service providers each with their own vested interests and conflicts.

A multi-stakeholder Governance Council or Standards Board modelled along the lines of the PCAOB with representation from a wide group of stakeholders could act as a central resource for addressing the full range of governance and proxy issues. We believe that such a framework would spur competition and innovation; reduce conflicts of interest and enable appropriate regulation which is sensitive to the needs of all participants. Very importantly such a forum would have a strong representation from real shareholders as the providers of capital, including the retail segment. This would, we believe, be consistent with the original 1930s founding mission of the SEC.

Many international markets successfully operate corporate governance and stewardship code frameworks on this basis. See, for example the work of the European Corporate Governance Codes Network¹⁹ (ECGCN), an informal group of bodies responsible for the

¹⁹ <https://sway.office.com/tDCd1K9NpuuL6Dvs?ref=Link&loc=play>

editing and/or monitoring of national codes in EU and EEA countries. There are currently 28 countries represented in this network.

2.5 Proxy Advisory Firms

As a “proxy advisory firm” we obviously have a vested interest in this part of the debate. That said, we bring a different perspective. Firstly, it is an experience grounded in overseas markets where proxy governance issues operate differently, but successfully; secondly it comes from operating a different business model which is not predicated on voting recommendations. Our main comments on this aspect of the consultation are covered in a separate section, S3 below.

2.6 Other Commission Action

Universal proxy cards are used elsewhere in the world without complexity or difficulty, we strongly encourage the SEC to reconsider their use.

Voting confidentiality: In an era of data confidentiality, it is extraordinary that any third-party could sell or publicise information about the likely voting intentions of shareholders without that shareholder’s permission. It’s akin to a postal worker opening mail packets and auctioning a preview of the contents before delivery. Social media firms have rightly been berated for such practices, the voting system should be reviewed on the same basis.

Standing Instructions: We do not agree that mandatory voting or standing instructions will benefit anyone, except perhaps intermediaries who earn volume-related processing fees. Bearing in mind the criticisms levelled against institutional investors for their “empty voting” why would we wish to see the same possibility being created for another segment of the market? We understand that corporations and some intermediaries may be missing the Rule 452 Broker Discretionary Votes,²⁰ however, such default voting is every bit as much zombie voting as any standing instruction deployed without consideration. If anything is rampant, it is the Main Street Investors Coalition (MSIC).

We have noted the MSIC’s criticisms of automatic voting by proxy advisors²¹ but not by any other organisation. Ignoring the fact (or possibly are ignorant of) that custodians and proxy distributors also offer standing instructions and pre-populated proxy ballots they only reinforce their biased approach. If anything is rampant²² it is the MSIC’s fevered imagination.

ADRs: We note that the SEC has recently been reviewing the operation of the ADR market which has a number of significant fines²³. ADRs create additional burdens in the voting

²⁰ <https://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf>

²¹

http://ignites.com/c/2123673/253413/groups_stop_autopilot_proxy_voting?referrer_module=emailMorningNews&module_order=8&code=YTJGMGFHVnlhVzVsTG14bFpVQm1kR2xqYjI1emRXeDBhVzVuTG1OdmJTd2dNVEExTURJM05qTXNJRGswTnpjMU9USTRPUT09 [£ pay wall]

²² <https://mainstreetinvestors.org/new-report-details-rampant-robo-voting-in-line-with-proxy-advisory-firms-recommendations/>

²³ <https://www.reuters.com/article/us-usa-sec-citibank/sec-fines-citibank-more-than-38-million-for-mishandling-adrs-idUSKCN1NC2EE>

process due to the complexity of ownership arrangements. We therefore request that you add ADR voting to your agenda.

Stock Lending/Empty Voting: Stock lending fulfils an important role in market liquidity but can have adverse consequences. Improved record dates (i.e. closer to the vote cut-off) would offer immediate market efficiencies by enabling economic and democratic ownership to be tightly connected. In addition to the ICGN Securities Lending Code²⁴, The Bank of England currently operates a code of conduct for stock lending which has been very helpful in addressing concerns about empty voting²⁵.

Binding/Non-Binding Votes: For shareholder votes to have their full democratic authority, we believe that all votes that receive majority support should be binding on boards. In the UK, nearly all votes are binding (except, notably, the advisory vote on executive pay policy implementation). According to our records which date back to 1997, average dissent on all resolutions rarely exceeds 5% overall.

Individual Director Voting: Shareholders have a strong preference for voting on individual directors rather than slates.

Pooled Fund Voting: We recognize that some fund managers are reluctant to accept voting direction on the grounds that it dilutes their own voice and stewardship influence. For others the opportunity to educate and inform their clients through their statements of investment and stewardship beliefs provides an excellent entry point into the investment process and support the saving journey. Some investor disclosures are of an outstandingly high quality and explain very clearly how ESG and good governance protect shareholder interests. Retail investors should therefore be able to make informed choices about their fund manager from the literature provided. In terms of improving disclosure, the SEC may wish to consider if it would be more helpful to move away from recommending Form N-PX type disclosures which simply provide laundry lists of votes with no context and instead encourage more qualitative disclosures which provide context and promote deeper understanding. This would also help issuers.

For larger pension fund or foundation type investors the situation is slightly more complex. It is theoretically possible to offer directed voting, subject to the fund manager's agreement, but the pooled custodian arrangements make voting transparency practically impossible. Ultimately, this becomes a commercial issue – those fund managers willing and able to offer a better service should be able to attract clients looking for particular solutions.

²⁴ https://www.icgn.org/sites/default/files/2007%20Securities%20Lending%20Code%20of%20Best%20Practice_0.pdf

²⁵ <https://www.bankofengland.co.uk/markets/money-markets-committee-and-uk-money-markets-code>

3 Proxy Advisory Mythology

The SEC, elected representatives and the general public have been subject to a barrage of lobbying in recent months. All of it has been carefully orchestrated and framed to suggest that proxy plumbing problems are down to proxy advisors. Despite the vast budget, flashy websites, Facebook and Twitter adverts, it is not just a case of “not proven”, there simply is not a case to answer. The lobby is entirely bogus, full of flimflam aimed at suppressing voters. It is a major distraction from the work that needs to be done; **fixing the plumbing**.

Proxy analysts are one small part of a vast system which is creaking from underinvestment over many decades. We could expend many hours rebutting arguments line by line, but that would simply entangle us in the very trap the lobby wish us to fall into. And, as with the 2010 Concept Release deliberations, we would make no progress in addressing the real problems in the system – **the plumbing**.

While both ISS and GlassLewis are competitors, the attack on the industry is a bi-partisan issue. ISS is right to use the term “mythology”, it’s a term that we have used for many years and we have no hesitation in joining both ISS and GlassLewis in some myth-busting of our own. In summary:

1. There are more than two proxy advisors and more than US-domiciled vendors who have an interest in US governance issues.
2. Not all proxy advisors make voting recommendations. Some, like Minerva, provide in-depth research and unique data models per customer to accurately and consistently flag policy issues which are of interest to investors.
3. Voting recommendations cannot be said to be either accurate or inaccurate, they are a point of view. Proxy advisors and their clients are fully entitled to have their own points of view about what constitutes risk and good governance.
4. Governance and ESG are not social or political missions. There is no shortage of case studies demonstrating how bad governance and poor ESG practices destroy value and jeopardise jobs and communities.
5. Voting recommendations and outcomes are not as correlated as is asserted. We can demonstrate that our voting policy framework is, despite our low market share, more closely correlated with shareholder dissent. This is because our framework offers a granular and transparent way to identify investor concerns.
6. Not all proxy advisors provide consulting services to the issuer community.
7. Not all investors outsource decision making to their service providers. If there is inappropriate outsourcing the SEC has investment management regulations to address this.
8. All proxy advisors have fiduciary responsibilities towards their clients through normal business and contract law.

9. Proxy advisors are either regulated, for example, ISS is already SEC-regulated or abide by a Code of Conduct such as the BPP Code.
10. If investors, as fiduciaries, are not fulfilling their regulatory obligations, then creating new regulations for service providers will not address that behaviour. In fact, more regulation would legitimise outright delegation and so not have the desired effect of greater integration with the core investment process. A more constructive approach would be to determine and settle once and for all what acts can be delegated in which market – the definition of fiduciary acts is not globally consistent and so clarity is essential.
11. The issue of errors is grossly overstated. No business process is infallible, as the GFC and audit crisis has shown. Like market news platforms such as Bloomberg, Refinitiv (Thomson-Reuters as was), FactSet etc, proxy advisors collate hundreds of thousands of data points quickly and efficiently. The actual error rate, whether material or minor is substantially below the complaints of a self-selecting few. We note that a report prepared for the primary lobbyists against proxy advisors, American Council for Capital Formation, has admitted that the evidence is not representative.²⁶
12. Not all proxy advisors send reports to issuers for pre-publication review. Minerva used to, until we found that issuers were then breaching copyright and sending the reports to advisors who would then charge the issuer many thousands of dollars to aggregate our report along with our competitors. We no longer provide free copies of our reports. We are accountable to our asset owner/manager clients first and foremost; sending reports to issuers detracts from the role of investors as the stewards of capital. Any corporate is welcome to buy reports for themselves or peer group companies just as they can buy copies of the Wall Street Journal or the Financial Times.
13. Mandating pre-release of research reports would be an extraordinary and outrageous intrusion which would not be tolerated anywhere else in normal business. Proxy advisors do not receive draft annual reports to check for errors -we wait until they are published and then we find them.²⁷
14. Issuers are not and should not feel obliged to respond to requests to review reports or engage with advisors. Many investors would prefer that engagement is directed to them rather than intermediaries.
15. Selective engagement with some investors and not others risks creating market abuse.
16. If issuers believe they don't have enough time to consider proxy advisor reports then they should consider that their shareholders would also to have more time to review

²⁶ http://cdn.accf.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport.pdf “[T]he relatively small data set (and the non-random survey methodology) do not allow statistically significant conclusions to be drawn.” Page 9

²⁷ <https://www.manifest.co.uk/manifest-research-impact-illegal-dividends-frc-icsa-act-to-ensure-compliance/>

annual reports. There are too many meetings that take place at the same time and so the issue of AGM date “bunching” should be reviewed.

17. It is no more appropriate for a corporation to read a pre-publication report than it is to ask to review a journalist’s copy before publication. It is regrettable that some proxy advisors do this as the practice is now frowned upon even for sell-side analysts.
18. Not all proxy advisors engage on behalf of investors, nor should they. It detracts from the relationship between the corporation and the investor.
19. Corporations spend many tens and often hundreds of thousands of dollars on market communications to manage their image and reputation. Is it fair or reasonable that one of the few independent sources of market intelligence that investors use is subject to issuer interference? The lobby against proxy advisors has reached such a frenzy that looks more like a blatant attempt at corporate censorship than invigorating informed stewardship.
20. Proxy advisors have different business models. Minerva does not provide consulting services to issuers and its ownership structure is independent of any institutional shareholder. If there are, as alleged, conflicts then there are already regulations, not to mention contract law which address this. The more important issue is the size of the market and lack of switching which more than likely is the result of poorly drafted regulation and guidance together with lack of enforcement.
21. The overwhelming majority of votes are cast in favour of management. Using the logic of our detractors these votes must also be inaccurate.
22. We do not believe in mandatory voting. Compliance-driven voting detracts from thoughtful and informed voting and undermines the work of engaged investors. However, removing the regulations that require mandatory voting would probably not now change voting levels due to the increased demands for better stewardship from asset owners. If there is “zombie voting” then the SEC already has the power to address this through its oversight of banks, brokers and asset managers.
23. We welcome the SEC’s withdrawal of the so-called Egan Jones letters.²⁸ We have always felt that they misunderstood the original request for intervention and made an already difficult market structure more polarized by focussing on certain firm characteristics at the expense of diverse points of view and innovation.
24. For a pro-free trade lobby to propose more regulation to enable free trade is beyond parody. As they know, bad regulation is bad for competition and diversity.

²⁸ <https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters>

3.1 Myth: Correlation is Causation

Critics of proxy voting have resorted to using non-peer reviewed policy papers from academics who have been paid to present arguments to support their patrons. The funding is rarely disclosed and the methodologies superficial.

FACT: critics ignore the underlying granular data and policy points which would, even without a recommendation, have resulted in a negative vote based on investor policies. There are plenty of examples of high dissent meetings where proxy advisors have recommended in favour, but investors have then exercised independent judgment.

3.2 Myth: All Proxy Advisors Make Voting Recommendations

Critics assert that investors are being led astray by ill-informed voting recommendations.

FACT: Uniquely, and contrary to the widespread mythology about proxy advisors, **Minerva does not make voting recommendations.**

Minerva's offering is predicted on the belief that:

- Investment professionals are the ones best placed to make the final determination about how their voting fits their investment thesis.
- Research, information and technology specialists like Minerva are best placed to develop and maintain the systems and data management tools to support investors.

Minerva supports the logistical challenges of the highly-compressed AGM season with comprehensive tools to support informed stewardship. Our sophisticated policy engine provides highly-customised voting alerts based on a client's individual preferences. Using data from public disclosures our algorithms objectively flag potentially contentious issues which are tailored to local market practices. Our process provides a comprehensive and transparent audit trail of all the issues that might impact a decision rather than a binary Yes or No.

3.3 Myth: Proxy Voting Policies are Not Transparent

Critics of voting recommendations ignore the fact that a recommendation on its own is a subjective point of view and that investors blend those points of view with their own research and data analysis.

We know from over 20 years' experience that our data-driven policy model is more closely aligned with dissent at shareholder meetings than raw voting recommendations.

FACT: All proxy advisors publish their methodologies; indeed, some undertake public consultations on their policies. Minerva does not use questionnaires because we believe they can potentially distort the policy debate. Instead, the issues which drive our research process are derived from:

Category	Example
Client Requests	This is our primary source of policy.
Academic research	European Corporate Governance Institute ²⁹
Desk research	Minerva has been researching board gender diversity since 1997.
Global recommendations	G20/OECD Principles ³⁰
Investor policies	Norges Bank Investment Management ³¹ or NEST
Local market codes	UK Governance Code ³²
Local market collective good practice standards	Commonsense Principles ³³

This powerful combination of global regulatory knowledge, expertise in proxy operations and technical capability helps investment fiduciaries make individual and fully informed voting judgements which are then executed according to investors' individual specifications.

3.4 Myth: Proxy Advisors are the Proxies

It is said that proxy advisors control the proxies and that we gather proxies to drive our own social and political agendas.

FACT: As research analysts and voting platform provider we are not “the proxy”, nor do we “solicit proxies”. We are an agent fulfilling our clients' operational requests. Our clients are very firmly in the driving seat of their voting decisions. We are a technical facilitator of informed stewardship by investors.

3.5 Myth: Proxy Advisors Push Political and Social Agendas

FACT: While the sponsors of the Main Street Investor Coalition have a strong anti-climate change heritage,³⁴ our clients have regulatory obligations to consider the impact of environmental, social and governance issues, together with climate change risks.³⁵ Reporting guidelines for corporations from national regulators also require disclosure of climate-related risks.^{36 37}

To be clear, investors are intensely focussed on protecting investors' savings from a wide range of long and short-term risks whether that is adverse interest rates, missing money, or cyber-security oversight failure.

²⁹ <https://ecgi.global/>

³⁰ <http://www.oecd.org/corporate/principles-corporate-governance.htm>

³¹ <https://www.nbim.no/en/responsibility/our-voting-records/voting-guidelines2/>

³² <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>

³³ <http://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf>

³⁴ <https://corpgov.law.harvard.edu/2018/06/14/the-main-street-investors-coalition-is-an-industry-funded-effort-to-cut-off-shareholder-oversight/>

³⁵ <http://www.thepensionsregulator.gov.uk/docs/db-investment-guidance.pdf>

³⁶ <https://www.fsb-tcf.org/>

³⁷ <https://www.fca.org.uk/news/press-releases/fca-opens-discussion-impact-climate-change-and-green-finance-financial-services>

3.6 Fact: The Proxy Advisory Market is Unduly Concentrated

Comparisons are often made between proxy advisors and credit rating agencies. On the one hand the comparison is wrong, we are paid by investors, we do not solicit ratings fees from issuers.

On the other hand, there are aspects of the argument which ring true: the size of the market is too concentrated which leads to lack of diversity. Another comparable market concentration problem might be the audit industry which has grown dependent on non-audit fees with only four organisations being considered adequate to perform large audits.

In comparison with investment research from brokers or data vendors, there is a lack of multi-sourcing, switching and tendering for proxy services. This creates an unhelpful market dynamic which discourages competition. New entrants are expected to have many years' experience and a global network. Realistically this would require a significant capital investment with an uncertain payback if investors are reluctant to switch. The Spitzer Settlement³⁸ contained a number of interesting features which could be applicable to the proxy industry, specifically separation of advisory activities, pump-priming and investor education.

It is said that US market, indeed the global market, is dominated by two vendors who are said to have a 97% is the market share,³⁹ although these figures have never been subject to any rigorous scrutiny. However, if that scale of domination were true, then it would be a matter of great concern. From our own experience we would say that the market is unduly concentrated, and the dominant advisors have the power to exclude new entrants through predatory behaviour. A major concern for the few remaining independents therefore is whether the risk of predation combined with the cost and burden of additional regulation would make it uneconomic to remain in the market. It is worth noting the consolidation of the proxy advisory industry in recent years.

1. ISS was acquired by Proxy Monitor 2001 and the new entity re-branded as ISS⁴⁰
2. IRRC⁴¹ the only other non-recommendations proxy analysts was acquired by ISS in 2005
3. ProxyGovernance Inc⁴², the firm created by former SEC Commissioner, Steve Wallman was closed in 2011.

3.7 Fact: Proxy Advisors are Regulated

Critics also ignore the basic facts of business– we have a fiduciary duty to our clients as part of our contractual relationship. We are also bound by laws of libel, insider trading etc.

³⁸ https://www.pbs.org/newshour/economy/business-july-dec02-settlement_12-20

³⁹ <https://www.forbes.com/sites/tedknutson/2018/04/26/proxy-advisory-firms-get-shotgun-treatment-from-wall-street/>

⁴⁰ <https://www.professionalpensions.com/global-pensions/news/1458765/proxy-monitor-acquires-iss-thomson>

⁴¹ <https://www.globalcustodian.com/institutional-shareholder-services-acquires-irrc-commercial-business/>

⁴² <https://www.businessinsider.com/did-ey-make-the-right-move-to-acquire-pgi-2011-6?IR=T>

If a proxy advisor is giving investment advice, then we agree they should be regulated under the relevant regime for investment advisors. However not all proxy analysts provide investment advice. The irony of the debate around proxy advisors is that the largest and most criticised advisor, ISS is SEC-regulated. Minerva is not regulated by the FCA. This is because we do not give advice which would lead to the purchase or sale of securities, the central tenet of the Financial Services & Markets Act which establishes the UK regulatory regime⁴³. However, for many years we have embedded the CFA Analyst Objectivity Standards⁴⁴ in our working practices. We are founder signatories of the Best Practice Principles for Shareholder Voting.⁴⁵

4 Conclusion

It would be unwise to distil the many complex arguments into a few simplistic bullet points. It is very easy for critics to carp, it is more helpful to find solutions. In closing we would say that:

- There is universal agreement that **the proxy plumbing**, the execution and delivery of votes is in urgent need of attention.
- The criticism of proxy research has reached a level of hysteria which would be laughable if the consequences of mis-regulation were not so far-reaching.

We urge the SEC to stay focussed on **modernizing the plumbing**. The critics of proxy advisors will never be satisfied until they control the industry entirely. Therefore, in closing we leave the last word to John Stuart Mill:

“If all mankind minus one were of one opinion, and only one person were of the contrary opinion, mankind would be no more justified in silencing that one person, than he, if he had the power, would be justified in silencing mankind.”

John Stuart Mill (1806–1873). On Liberty. 1869. Chapter II: Of the Liberty of Thought and Discussion.⁴⁶

****End****

⁴³ <http://www.legislation.gov.uk/uksi/2001/544/part/II/chapter/XII/made>

⁴⁴ <https://www.cfainstitute.org/en/ethics/codes/research-objectivity-standards>

⁴⁵ <http://bppgrp.info>

⁴⁶ <https://www.gutenberg.org/files/34901/34901-h/34901-h.htm>