SOUND & VISION

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

SEC Staff Roundtable on the Proxy Process – File Number 4-725
Post-Roundtable Comments of Sound & Vision Analytics

Dear Mr. Fields:

At the SEC's recent Roundtable on the Proxy Process, Chairman Clayton emphasized that an important goal of the proxy process is to achieve informed, company-specific votes:

> "People whose money is in for the long-term want to know that the investment adviser, whether using a proxy adviser or not, is making not just an informed voting decision across our companies, but an informed, company-specific voting decision. That's where we're trying to get to – are they getting that informed, company-specific voting decision." [1]

Sound & Vision Analytics LLC ("Savanalytics"),[2] in response to the Chairman's request that this issue be addressed in post-Roundtable comments, makes this filing to outline our suggestions on concrete steps the SEC could take to encourage and facilitate the more widespread use of informed, company-specific proxy voting decisions. While many major investment advisers and investment funds do engage in nuanced, and informed, voting, the proxy-advisory industry continues to be characterized by a check-the-box, one-size-fits-all approach. The time for that model is well past its "use by" date.

As outlined in this submission and by many observers, now is the time to act not only because the current proxy-advisory system is inflexible, but also because its contours are largely contrary to the intent of the SEC's rulemaking and guidance in this area. Rather than leading to better proxy voting, it has led to the establishment of a small number of private companies, with no financial stake in the outcomes, as de facto standard setters with significant authority over corporate governance matters in the United States.[3] Moreover, unlike government regulators, these private companies are not subject to

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[1] Condensed from Chairman Clayton's comments as recorded from the SEC's webcast, available at www.sec.gov/video/webcast-archive-player.shtml?document_id=111518roundtable.

[2] Savanalytics is an early-stage governance startup, which plans to provide bespoke analyses of issuers and to publish thought pieces for the broader investment community.

[3] *See, e.g.*, former Commissioner David Gallagher's recent testimony before the Senate Banking Committee, at 3-5 (December 6, 2018) www.banking.senate.gov/imo/media/doc/Gallagher%20Testimony%2012-6-18.pdf.

due process requirements in conducting their unofficial rulemaking. This result is not only unintended, but also ironic, because as the SEC has emphasized, Congress restricted the SEC's role in the proxy process generally to ensuring full and fair disclosure, not to making substantive business decisions and judgments for issuers and their shareholders.[4]

Background

As many have noted, SEC rules and staff guidance over the years have contributed to the widespread use of proxy advisers and the current inflexible frameworks that they employ.[5] In particular, SEC rules and releases created the impression, if not the requirement, that institutional investors and investment advisers must vote all the shares they own or manage in every proxy vote.[6] In addition, based on the 2003 Proxy Voting Release, as well as now-withdrawn SEC no-action letters[7], many investment advisers understood that they could fulfill their obligations to vote their shares, and insulate themselves from potential conflicts of interest, by retaining and following the voting recommendations of proxy advisory firms.[8]

These two understandings gave rise to the proxy advisory business as it exists today. Investment advisers turned in large part to using proxy advisers to make voting recommendations in the proxy votes of the thousands of companies in their clients' and firms' portfolios. Faced with the gargantuan task of developing voting recommendations for thousands of companies and tens of thousands of votes, proxy advisory firms had little choice but to develop one-size-fits-all guidelines and frameworks, and that is precisely what they did.[9] Although there is some company-specific analysis, proxy advisory firms

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[4] *See, e.g.,* remarks by then SEC Chair, Mary Jo White, International Corporate Governance Network Annual Conference (June 27, 2016) ("Chair White Remarks") www.sec.gov/news/speech/chair-white-icgn-speech.html.

[5] *See, e.g.,* GAO Report to Congress, Corporate Shareholder Meetings (June 2007), at 6-7, available at www.gao.gov/new.items/d07765.pdf. *See also* James Glassman and J.W. Verret, "How to Fix Our Broken Proxy System," Mercatus Center at George Mason Univ., (2013) ("Glassman Article"), at 1-2, available at www.mercatus.org/system/files/Glassman_ProxyAdvisorySystem_04152013.pdf.

[6] *See* Proxy Voting by Investment Advisers, SEC Release No. IA-2106, (Jan. 31, 2003) ("2003 Proxy Voting Release"), available at www.sec.gov/rules/final/ia2106.htm, and Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, SEC Release No. IC-25922, (February 7, 2003), ("SEC Investment Company Release"), available at http://www.sec.gov/rules/final/33-8188.htm. Department of Labor guidance over the years has also contributed to this understanding and should also be addressed to achieve more nuanced proxy voting. *See, e.g.,* Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, (December 29, 2016) ("2016 DOL Release), available at www.dol.gov/sites/default/files/ebsa/2016-31515.pdf.

[7] *See* 2003 Proxy Voting Release at II.A.2; *Egan Jones Proxy Services,* SEC Staff Letter (May 27, 2004) ("Egan-Jones No-Action Letter"); *and Institutional Shareholder Services Inc*., SEC Staff Letter (September 15, 2004).

[8] *See* 2003 Proxy Voting Release and Egan-Jones No-Action Letter. *See also*, Remarks of Comm. Daniel M. Gallagher at Society of Corporate Secretaries & Governance Professionals, July 11, 2013, available at www.sec.gov/news/speech/spch071113dmghtm.

[9] *See, e.g.,* Charles Nathan, "Proxy Advisory Business: Apotheosis or Apogee?," *The Harvard Law School Forum on Corporate Governance* (April 6. 2011) ("Nathan Article"), at 6, https://corpgov.law.harvard.edu/2011/03/23/proxy-advisory-business-apotheosis-or-apogee/ ("As a result of the large number of voting recommendation that must be made in a short time period, it is inconceivable that proxy advisors' recommendations can or will be based on a thorough analysis of the facts and circumstances of each company.")

generally make their voting recommendations by matching their guidelines against the practices of the companies they evaluate, check the boxes that apply, and make their recommendations accordingly.

In 2014, however, recognizing the confusion among investment advisers about whether they were obligated to vote all shares, the SEC staff issued further guidance. In Staff Legal Bulletin No. 20, the staff made clear that there was no requirement under the statute or SEC rules that investment advisers vote all the shares they manage or to do so in every matter. The staff indicated, instead, that investment advisers and their clients have broad flexibility to agree to the scope of investment advisers' voting responsibilities, including as to when to vote, and the manner in which investment advisers should do so.[10]

The SEC staff's clarification that investment advisers are not required to vote all shares in all elections helped fix part of the problem. It still left unclear, however, the extent of investment companies' and other institutional investors' voting obligations.[11] In addition, the SEC staff did not withdraw (until recently) the no-action letters that seemed to sanction the wholesale use of proxy advisers, or the guidance in the 2003 Proxy Voting Release.[12] As a result, proxy advisory firms have generally continued to employ their principles-guided framework and methodology in making their voting recommendations.

The Problems with One-Size-Fits-All Approaches

The one-size-fits-all approach generally employed by proxy advisers has many serious flaws, including:

- It largely ignores the unique facts and circumstances that each issuer faces in running its business successfully, and the rationales that issuers provide in their proxy statements to explain the governance and other choices they have made;[13]
- It freely substitutes proxy advisers' views for those of issuers' boards, giving little to no deference to boards' fiduciary obligations to conscientiously consider their companies' unique facts and circumstances in carrying out their duties; [14]

[10] SEC Staff Legal Bulletin No. 20 (June 30, 2014), https://www.sec.gov/interps/legal/cfslb20.htm.

[11] See SEC Investment Company Release and 2016 DOL Release.

[12] In its withdrawal release (and elsewhere) the SEC staff also made clear that staff guidance is non-binding in any event. *Statement Regarding Staff Proxy Advisory Letters* (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters. The need for more definitive guidance on these issues is discussed, *infra.*

[13] Although the major proxy advisory firms endeavor to correct any factual mistakes they make about issuers, they are quite clear that they will not debate their frameworks and guidelines as part of this process. *See* Comments of Institutional Shareholder Services Inc. at 10, SEC Staff Roundtable on the Proxy Process, File No. 4-725 ("ISS Roundtable Filing"), available at https://www.sec.gov/comments/4-725/4725-4629940-176410.pdf; Glass Lewis Comments at 6, SEC Staff Roundtable on the Proxy Process, File No. 4-725 ("Glass Lewis Roundtable Filing"), available at www.sec.gov/comments/4-725/4725-4649188-176490.pdf.

[14] Board members' fiduciary duties include the obligations to act on an informed basis (after due consideration of relevant facts, deliberation, and in appropriate circumstance, the advice of experts), in the best interests of their companies and shareholders, and free from conflicts. Contrary to applying one-size-fits-all rules, absent conflicts of interest, courts, applying the "business judgment rule," generally defer to the business judgments of boards of directors. *See, e.g., Aronson v. Lewis,* 473. A.2d 805, 812 (Del. 1984).

- It has led to the conflation of governance and business matters, including in the evaluation of core strategic decisions involving optimal pay practices and key corporate transactions;[15] and
- It elevates "shareholder rights" to an end in themselves, instead of acknowledging that reasonable limits on shareholder decision-making can in many circumstances better protect companies and their shareholders.[16]

Informed, Company-Specific Voting

Informed, company-specific voting is generally the opposite of voting based on one-size-fits-all guidelines. This is the case no matter how detailed those guidelines may be, because one of the most important aspects of being "informed," and "company-specific," is analyzing the rationales companies provide for their governance and other decision making.[17] Practices that are similar or identical across companies may be sensible for one company, but not another, based on each company's specific circumstances and rationales for adopting them.

One of the most fundamental responsibilities of a company's management and board is to develop and continually refine its overall corporate strategy and its constituent parts.[18] This involves the hard and ongoing work of analyzing their company's unique facts and circumstances, including an evaluation of its potential areas of competitive advantage, the strengths and weaknesses of its executive team, its evolving competitive and regulatory landscapes, and many other factors. Ideally, each decision a company makes, including ones related to governance, such as pay practices, capital structure, and anti-takeover defenses, should be tightly bound to its unique facts and its fundamental strategic plans.[19]

Because each corporate decision should be closely linked to a company's underlying strategy, these decisions can only be understood in that context, including issuers' explanations of the fit between their decisions and their unique circumstances and objectives.[20] This means that while guidelines may be

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[15] For example, Netflix in its 2018 Proxy Statement makes clear that its approach to compensation is a fundamental pillar of its competitive strategy, which focuses on succeeding by attracting and retaining "outstanding performers." Netflix appears to have been quite successful with this strategy, but its core compensation practices seem at odds with the guidelines of the major proxy advisers. Among other things, Netflix (i) allows each Named Executive Officer to determine the mix of pay received from salary, stock options, and target bonus, (ii) awards stock options that have no vesting period, and (iii) generally pays at the top of industry pay scales without calibrating pay to percentiles derived from analysis of peers. *Compare* Netflix 2018 Proxy Statement at 38 – 45, www.sec.gov/Archives/edgar/data/1065280/000119312518125771/d522527ddef14a.htm *with* ISS 2018 U.S. Proxy Voting Guidelines at 38 to 44, www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf.

[16] *See, e.g*. Commonsense Principles 2.0. ("Commonsense Principles"), available at www.governanceprinciples.org The Commonsense Principles, published by a group of prominent CEOs and investment managers, take a very nuanced view of governance issues. Among other things, they recognize that measures such as written consent provisions should include reasonable minimum share requirements "in order to prevent a small minority of shareholders from being able to abuse the rights of other shareholders or waste corporate time or resources."

[17] The Commonsense Principles, and many investment advisers, recognize the importance of understanding issuers' rationales for their practices in order to evaluate them, especially as to "a novel or unconventional approach." Commonsense Principles at VIII(a).

[18] *See generally, e.g.,* Michael E. Porter, "What is Strategy?," Harvard Business Review (November-December 1996).

[19] Id.

[20] Indeed, BlackRock lists as a factor for voting against an issuer's compensation committee members if BlackRock "determine[s] that a company has not persuasively demonstrated the connection between strategy, long-term

useful as a tool to identify areas of potential concern, they can never substitute for reviewing a company's explanation of how a particular practice advances its strategic vision.[21] Similarly, comparisons to "peer" companies may provide a useful preliminary screen, but such evaluations are not sufficient on their own to provide meaningful analyses.[22] For one thing, the goal of most companies should be to win in the marketplace, not to come within some arbitrary percentile of others in it. For another, pay that is reasonable at one company based on its fit with its strategy, may be excessive if used by another company with different goals and objectives. Indeed, excessive reliance on peer analysis can lead to ratcheting up of pay by all companies, as each uses the pay of the highest peer to justify increases in its own executive compensation.[23]

It is also worth emphasizing that the point of understanding companies' rationales for their practices isn't to second guess their business judgments, but to understand them, and to accord them a proper level of deference when it is appropriate to do so.[24] In that regard, while proxy advisory firms claim that they do employ company-specific analysis, including consideration of issuers' rationales for their decisions, they appear to be generally unwilling to deviate from their pre-determined principles in their analyses, and to instead evaluate the perceived shortcomings of issuers' practices against their own principles.[25] Such an approach is not truly company-specific.[26]

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shareholder value creation and incentive plan design." BlackRock voting guidelines for U.S. securities (February 2018) ("BlackRock Voting Guidelines") at 20.

[21] As Warren Buffett has remarked: "Checklists are no substitute for thinking." Quoted in Glassman Article at 18.

[22] Over-reliance on peer analysis is also unwarranted given the significant differences among companies that are generally employed as peers by issuers and proxy advisers in terms of product mix, component businesses, histories and myriad other factors. As ISS has acknowledged as to conglomerates: "Almost by definition, a conglomerate has no true peer (since no other conglomerate has the same portfolio of businesses in approximately the same mix)." DuPont: proxy contest with Trian Fund Management, ISS Special Situations Research Analysis, at 1, (April 26, 2015) ("ISS DuPont-Trian Rpt.") available at www.issgovernance.com/file/publications/dupont_ssr.pdf.

[23] *See* BlackRock Voting Guidelines at 18 ("We acknowledge that the use of peer group evaluation by compensation committees can help ensure competitive pay; however, we are concerned about the potential ratchet effect of explicit benchmarking to peers."

[24] *See supra*, fn. 14, discussing the business judgment rule.

[25] *See, e.g.,* ISS U.S. Compensation Policies FAQs (December 14, 2017) at 13-14 (indicating that ISS's qualitative compensation analysis focuses on evaluating issuers' practices against ISS's guidelines) available at https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf.

[26] Analysis is not company-specific even in areas where proxy-advisers employ case-by-case reviews to the extent that they apply and are unwilling to deviate from their pre-determined guidelines regardless of issuers' company-specific rationales. Proxy advisers' reviews of major corporate transactions and proxy contests, however, are often company specific. As discussed above, however, the problem with these reviews is that they often conflate corporate governance and strategic matters, and accord little or no deference to issuers' boards. In addition, as discussed below, the SEC should do more to require that investment advisers who hire proxy advisers to provide voting recommendations in these matters ensure that such proxy advisers have the "capacity and competency to adequately analyze" these core business and strategic issues.

The Power of Proxy Advisory Firms

The major proxy advisor firms argue, when it suits their purposes, that the extent of the power and influence they wield is quite limited. Among other things, they claim that their clients retain the right to, and sometimes do, make their own final decisions on voting matters and, in many cases, that it is their clients who determine their own voting guidelines, which the proxy advisers then just mechanically execute. These arguments miss the point.

First, although the precise size of the vote that proxy advisers influence is subject to debate,[27] it is clear that the percentage is significant enough for issuers to take note of the proxy advisers' guidelines in making the decisions that the proxy advisers will evaluate.[28] Indeed, empirical studies show that issuers often alter their governance and other decisions to come within proxy advisers' frameworks in order to obtain favorable recommendations from them.[29] Thus, regardless of the precise number of votes they influence, proxy advisers' guidelines and standards affect all investors (including the major investment advisers and institutional investors that do undertake their own company-specific analysis), since it is the conduct of the issuers themselves that they impact. One of the major proxy advisers acknowledged this impact in its filing at this Proxy Process Roundtable:

> "ISS also back tests any proposed changes [to its guidelines] to understand the possible impact of the various policy options being considered. Such impact assessments often lead ISS to phase-in new policies over a multi-year period to allow corporate issuers adequate time to prepare for any changes."[30]

Second, although the major proxy advisory firms have built platforms that can implement their clients' own guidelines, or ones their clients develop with the help of the proxy advisers, this exacerbates, rather than mitigates, the extent of non-company-specific voting decisions. The major proxy advisory firms acknowledge that they apply their clients' guidelines in a very mechanical way, giving them little or no ability to consider the issuers' rationales for the decisions they have made.[31] For the reasons

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[27] See, e.g., GAO Report, Corporate Shareholder Meetings, Proxy Advisory Firms' Role in Voting and Corporate Governance Practices (2016) at 15-16 (setting out ranges of potential voting impact found by various studies), https://www.gao.gov/assets/690/681050.pdf.

[28] Proxy advisory firms have also been candid about the scope of their influence in addressing issuers themselves. For example, in its marketing of its consulting services to issuers, ISS claims: "Understanding how proxy advisors and institutional investors evaluate equity plans is an essential component of structuring a proposal that shareholders will support, particularly as goal posts move to address shifting annual benchmarks." Available at www.isscorporatesolutions.com/design-equity-plan-proposals/.

[29] *See* James Copland, David Larcker, and Brian Tayan, "The Big Thumb on the Scale: An Overview of the Proxy Advisory Business," Rock Center for Corporate Governance Stanford Closer Look Series – CGRP72, at pp. 4-5 (collecting studies); available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3188174.

[30] *See* ISS Roundtable Filing at 11. *See also* Pearl Meyer Report, The Myth and Reality of TSR as an Incentive Metric at 4, 11 (finding that although empirical evidence shows that Total Shareholder Return (TSR) is not an effective driver of company performance, its wide use in issuers' long-term incentive plans is due in significant part to its use by proxy advisory firms) available at www.pearlmeyer.com/myth-and-reality-tsr-incentive-metric.pdf.

[31] See Glass Lewis Response To SEC Statement Regarding Staff Proxy Advisory Letters (Sept. 14, 2018), http://www.glasslewis.com/glass-lewis-response-to-sec-statement-regarding-staff-proxy-advisory-letters/ ("While Glass Lewis works with each client to implement the client's respective proxy voting policy on Glass Lewis' Viewpoint vote management platform, the formulation of the actual policy is at the sole discretion of the client.

discussed above, no matter how detailed the criteria employed, application of them in this manner is not company specific.[32]

The power of proxy advisory firms, together with their one-size-fits-all approach for their own guidelines and their mechanical execution of clients' guidelines, serve to limit the ability of companies to devise and implement their own unique strategic plans and choices. This, in turn, limits the choices issuers can make and, ultimately, the investment options that are available to investors.[33]

Steps the SEC Can Take to Facilitate Informed, Company-Specific Voting Decisions

The SEC staff's withdrawal of the proxy adviser no-action letters, its convening of this Roundtable, and its 2014 guidance are helpful steps toward needed reform of the proxy voting process. But as the SEC has repeatedly and recently reiterated: "Staff guidance is nonbinding and does not create enforceable legal rights or obligations."[34] This means that action by the Commission[35] itself is needed to clarify the obligations of institutional investors, investment advisers and proxy advisers regarding proxy voting, and to facilitate the creation of a new model that would be both more informed and company-specific.[36]

Although many have called on the Commission to take limited steps such as requiring proxy advisers to improve the processes they use to correct any factual errors they make, such proposals would only address minor problems in the proxy-voting process. The fundamental problem isn't discrete mistakes, but the inflexible, one-size-fits-all-frameworks that most proxy advisers employ.

Imposing regulations on proxy advisory firms, however, wouldn't fix this problem. They were created or grew to fill a need created by the regulatory guidance that the SEC (and DOL) provided. Their one-size-fits-all frameworks, as discussed above, are the only feasible way for them to analyze the thousands of companies and tens of thousand of votes that the current rules may still require investment advisers to deal with. In addition, their business models, and core competencies, may not be ideally suited to conducting company-specific research.[37]

To get to the root causes of the problem, the Commission should reexamine the aspects of the SEC rules and guidance that led to the creation of the current system. In particular, the Commission should clarify

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Glass Lewis does not have the discretion to deviate from a client's instructions or to determine a vote that is not consistent with the policy specified by the client.")

[32] Boards that made their decisions based on mechanical application of pre-determined guidelines would most likely be in breach of their fiduciary duties. *See supra* note 14. Evaluating their decisions in that manner, therefore, cannot be a sensible approach.

[33] If Netflix, for example (*see surpa* note 15), had followed the proxy advisers' views on "pay for performance," this would have thwarted its ability to implement its fundamental strategy to succeed by attracting the best talent through generally paying the highest salaries and without vesting periods for awards of company stock.

[34] *Statement Regarding Staff Proxy Advisory Letters* (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters. *See also* Chairman Jay Clayton, *Statement Regarding SEC Staff Views* (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-clayton-091318.

[35] "Commission" is used in this submission to distinguish formal agency action from nonbinding SEC staff guidance.

[36] Many parties, including proxy firms, agree that there is need for the Commission to clarify these obligations. *See, e.g.,* ISS Roundtable Filing, at 3.

[37] *See, e.g.,* Nathan Article at 7.

that there is no obligation under its rules for institutional investors or investment advisers to vote all the shares they own or manage in every company or every matter. The Commission should also modify or clarify the guidance on conflicts of interest that contributed to the decision of investors and investment advisers to outsource proxy voting to proxy advisory firms. Finally, the Commission should formalize and clarify the obligations set out in Staff Legal Bulletin No. 20 (and the withdrawn Egan-Jones no-action letter) regarding the obligation of investment advisers in retaining proxy advisory firms to "ascertain that the proxy advisory firm has the capacity and competency to adequately analyze proxy issues." Among other things, the Commission should clarify that any retained proxy advisory firm must have competency in all matters on which it proposes to provide voting recommendations, and that this may require the retention of more than one proxy or other adviser (to the extent the investment adviser decides not to analyze particular issues itself).[38]

Clarifying that institutional investors and investment advisers are not required to vote all shares would be a significant step toward achieving informed, company-specific voting.[39] Freed from the obligation to cast every vote, institutional investors and investment advisers would be able to focus on the companies and issues that matter most to them and their investors, looking more closely at the unique facts of each issuer, and facilitate their ability to use their own expertise, rather than that of outside proxy advisers, to evaluate the most important strategic issues.[40] Indeed, the largest institutional investors, where the costs are more manageable, already engage in and stress the importance of company-specific analysis and voting, and generally rely less on proxy advisers than smaller firms. The new rule should make this feasible for more institutional investors to do so.[41] Moreover, reducing the burdens of voting all shares would enhance the ability of investment advisers to consider the unique circumstances of their own portfolios and investment objectives in voting their shares, allowing the company-specific goal to be better met in both directions.[42]

In order to not lose sight of the fundamental requirement that investment advisers vote their shares in the best interests of their clients, the Commission should also provide guidance about the factors that investment advisers may use in deciding when, and when not to, vote. Fundamentally, this could include

[38] Indeed, one of the problems with wholesale outsourcing to proxy advisers is that institutional investors and investment advisers often possess significant (and greater) expertise in the strategic matters than the proxy advisory firms they use to provide such advice on. Many of these matters, such as valuations and the consideration of strategic alternatives proposed in proxy contests, are more in the nature of the investment decisions that active institutional investors and their investment advisers routinely make in deciding whether to buy or sell securities than they are matters of corporate governance. See the discussion above regarding proxy advisers' conflation of governance and strategic matters.

[39] Several commentators have called on the Commission to clarify that there is no "vote-all" requirement in order to improve the quality of voting. *See, e.g.,* Glassman Article at 28 and Nathan Article at 7.

[40] *See* Glassman Article at 17 (noting the "perverse outcome of the current system is that regulators are effectively separating the evaluation of corporate governance from investment analysis by driving funds to use crude alternatives to assess proxies, rather than the analytic expertise that they tout as their competitive advantage").

[41] The Commonsense Principles stress the importance of company-specific analysis. They also caution that input from proxy advisory firms should only "form pieces of the mosaic on which asset managers rely in their analysis".

[42] *See, e.g.,* Chair White Remarks at 2 (noting that "Different investors, of course, may have different objectives and interests. Investors with relatively short-term investment objectives . . . often will have very different perspectives than long-term investors on a variety of matters, including those related to corporate governance, buybacks and sustainability practices, to name just a few.)"

an assessment of when the costs of voting (and analysis) would outweigh any benefits.[43] This itself would vary based on the size of the investment adviser and the portfolios that it manages. Other factors that should be considered could include the absolute and relative size of the stake in particular issuers, unusual compensation practices, and the extent to which a vote involves fundamental strategic matters that could impact the value of an investment.[44] Investment advisers should also be open to input from their clients, issuers, and proxy proponents about matters that these group believe are important for them to vote on.

The Commission should also reconsider the guidance on conflicts that it provided in the now withdrawn no-action letters and elsewhere. Rather than let the conflicts tail wag the good proxy voting dog, though, the Commission should be careful not to again suggest that wholesale use of proxy advisory firms is an ideal way for investment advisers to cleanse any conflicts.[45] As one commentator has noted, delegating proxy voting from investment advisers to proxy advisers meant that "the conflicts have merely been shifted to different firms."[46] Rather, as it does with conflicts of proxy advisers, the Commission should use disclosure, not delegation, as the primary way to deal with investment advisers' conflicts.[47] Indeed, in a neglected part of the 2003 Release, the Commission offered just that solution.[48]

Finally, in order to achieve the goal of more widespread use of informed, company-specific voting, the Commission should clarify, and strengthen, the obligations of investment advisers when hiring proxy advisers to ensure that all such firms they hire have "the capacity and competency to adequately analyze proxy issues."[49] Unlike the SEC's current guidance on this requirement, however, the new rules should make clear that proxy advisers must possess competency on every issue on which they would offer advice, and that clients' may, therefore, be required to obtain the services of more than one proxy advisory firm or other advisor based on the breadth of the issues that they will evaluate.[50] The

[43] In 2016 the Department of Labor retreated from an earlier view that suggested that ERISA plan fiduciaries should always engage in a cost-benefit analysis before voting proxies. *See* 2016 DOL Release. For the reasons set forth in this submission, the DOL should again reexamine this issue.

[44] Proxy advisers and other firms could provide value in monitoring issuers and upcoming votes, providing preliminary screens, and alerting particular investment advisers to votes involving issues and issuers that are of most concern to them.

[45] *See* Egan-Jones No-Action letter and 2003 Proxy Voting Release.

[46] Glassman Article at 21

[47] In offering the proxy adviser solution to the conflicts problem, the SEC also offered an alternative that an investment adviser "that votes securities based on a pre-determined voting policy could demonstrate that its vote was not a product of a conflict of interest if the application of the policy to the matter presented to shareholders involved little discretion on the part of the adviser." 2003 Proxy Voting Release. Suggesting a mechanical application of pre-determined guidelines would not produce company-specific voting, as discussed above, and should also be avoided.

[48] "[W]e believe that an adviser to an investment company would satisfy its fiduciary obligations under the Advisers Act if, before voting the proxies, it fully discloses its conflict to the investment company's board of directors or a committee of the board and obtains the board's or committee's consent or direction to vote the proxies." 2003 Proxy Voting Release, n. 20.

[49] Staff Legal Bulletin No. 20.

[50] As noted above, however, the elimination of the requirement to vote all shares in every matter would facilitate more analysis of key strategic matters by institutional investors and investment advisers themselves.

competency requirement should also have special teeth as to the evaluation of issues or matters that involve corporate strategy or major transactions.[51]

The Commission should also emphasize that "capacity and competency" means more than just the number of employees that proxy advisory firms employ.[52] More than numbers, this encompasses the ability to review the rationales issuers provide to justify their particular practices, not to just "check the box" to determine their fit with predetermined guidelines. Indeed, obligating investment advisers to ensure that proxy advisory firms have this type of capability and that investment advisers may be required to use more than one proxy adviser to meet this standard could help to end the existing duopoly in the market by facilitating the entry of additional proxy advisory firms, which might compete by specializing in different industries, issuers, and practices. In addition, emphasizing the need for special expertise in the evaluation of strategic matters should lead to more diversity of viewpoints and reduce the excessive degree of influence that existing proxy advisory firms have in determining the outcomes of major proxy contests and corporate transactions.[53]

Accordingly, we would recommend that the Commission commence a new rulemaking, that would consider or address the following:

1. Clarifying that institutional investors and investment advisers are not obligated to vote all shares in all matters as to the shares for which they have voting authority;
2. Providing guidance and illustrative examples of the factors institutional investors and investment advisers can employ in creating policies as to voting obligations;
3. Clarifying that investment advisers can deal with conflicts by disclosing them to clients and obtaining informed consents; and
4. Providing that in hiring proxy advisory firms, institutional investors and investment advisers have an obligation to ensure that each proxy adviser they retain "has the capacity and competency to adequately analyze proxy issues" on all the matters on which the proxy adviser proposes to offer advice or voting recommendations (quoting in part but modifying Staff Legal Bulletin No. 20).

[51] This submission is not intended to assess the qualifications of any particular proxy adviser, but to call on the Commission to strengthen the obligations of investment advisers to do so given the importance and complexity of the issues that they evaluate, especially in votes involving proxy contests and proposed mergers. *See, e.g.*, ISS DuPont-Trian Rpt. (evaluating issuer's and dissident's views on strategy, company valuation, and wisdom of a corporate restructuring).

[52] In Staff Legal Bulletin No. 20, the staff explained that "capacity and competency" includes "the adequacy and quality of the proxy advisory firm's staffing and personnel." At 2.

[53] See Michelle Celarier, *The Mysterious Private Company Controlling Corporate America, How eight men inside a Maryland office park decide the fate of the country's greatest companies*, Institutional Investor (Jan. 29th, 2018), https://www.institutionalinvestor.com/article/b16pv90bf0zbj8/the-mysterious-private-company-controlling-corporate-america.

Conclusion

The current inflexible one-size-fits-all model that characterizes the proxy-advisory process is largely the result of unintended regulatory consequences. This regulatory problem requires a regulatory fix: action by the Commission itself to clarify the proxy-voting obligations of institutional investors, investment advisors and proxy advisory firms in a manner that facilitates the development of informed, company-specific voting and analysis.

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Sound & Vision Analytics appreciates this opportunity to weigh in on these important issues and would be pleased to follow up with the Commission or staff at their request.

Respectfully submitted,

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