

March 7, 2019

VIA Electronic Delivery

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

RE: Comments on the SEC Roundtable on Proxy Process Issues – Proxy Advisory Firms

Dear Mr. Fields:

Proxy advisory firms play an important role in the proxy process by providing a service fundamental to the ability of many institutional shareholders to conduct necessary proxy voting in an economically efficient manner. However, the investors' need for proxy advisor services combined with two firms controlling roughly 97% of the market share for such services has yielded a situation where the proxy advisory firm industry still suffers from flagrant conflicts of interest and serious procedural shortcomings.

Our recommendations for the Commission provide market-driven solutions which remediate the concerns with the proxy advisory firm industry without the creation of an onerous oversight regime that negatively impacts the proxy advisory firm business model or acts as an industry barrier to entry. Further, our recommendations recognize the important role proxy advisory firms play within the proxy process.

**I. Proxy Advisory Firms - A Closed System of Economic Co-Dependency with a Wide Impact**

Currently, primary oversight of proxy advisory firms is achieved indirectly through the fiduciary duties of the primary customers of the proxy advisory firm – institutional investors and investment advisors. Conceptually, in fulfillment of the fiduciary duty when voting a proxy to do so in the best interest of their shareholders, an institutional investor or investment advisor holds the proxy advisory firm to high standards.

Unfortunately, the necessity of researching and voting thousands of shareholder and management proposals combined with extreme proxy advisory firm industry consolidation results in a system of economic co-dependency between proxy advisors and much of their clientele. Not only does this system directly result in a concerning lack of accountability, but it excludes other interested and impacted stakeholders, including any investor (*i.e.*, retail investors) which does not purchase proxy advisory firm services as well as issuers. Additionally, the proxy advisory firm system impacts the market generally by influencing proxy votes – including important governance policies and director elections.

There is currently no appropriate or fitting regulatory oversight applied to proxy advisory firms. Further, as detailed above, the economic advantages presented by proxy advisory firm services create questions as to the incentive and ability of any single institutional investor and adviser clientele to effectively police the industry. Without effective oversight, the proxy advisory firm industry has become known for conflicts of interest, lack of transparency, and serious procedural shortcomings.

The main issues within the proxy advisory industry which stem from the lack of oversight and accountability are:

- *Conflicts of Interest*: Major conflicts of interests inherent in the proxy advisory firm business and ownership structure;
- *Procedural Shortcomings in the Proxy Report Process*: The lack of opportunity for companies to provide reasonable input in the proxy recommendation process, including addressing a lack of rigor and accuracy with proxy advisory firm analyses; and
- *Adequate Review and Overreliance*: Given that proxy voting is a fiduciary activity, there are legitimate concerns with voting practices, particularly when votes are cast on behalf of an institutional investor without adequate review.

The importance and economic viability of proxy advisory firm services and adequate transparency and proper processes are not mutually exclusive. Given the importance of the proxy process and the role of proxy advisory firms, the Center On Executive Compensation urges the Securities and Exchange Commission to adopt this tailored regulatory regime. If implemented, our recommendations would achieve the following important objectives:

1. Recognize the economic necessity for proxy advisory firms within the proxy process while not creating additional barriers to entry;
2. Permit market participants to effectively evaluate and remediate conflicts of interest within the proxy advisory firm industry – without the need for constant SEC oversight;
3. Enhance the ability of institutional investors to fulfill fiduciary responsibilities when voting their proxies; and
4. Provide a reasonable voice for interested stakeholder groups currently excluded from the proxy advisory firm process.

The following summarizes the biggest areas of concern with the proxy advisory industry and outlines specific fixes which accomplish the objectives enumerated above.

## **II. Address Conflicts of Interest Through Mandatory Public Disclosure**

Conflicts of interest present the most important concern with the current state of proxy advisory firm operations. Notably, the Government Accountability Office as reported on the many conflicts of interest in the proxy advisory firm industry on multiple occasions.

The most egregious conflict of interest in the proxy process involves Institutional Shareholder Services, Inc., the largest and most influential proxy advisory firm. ISS has two lines of business: ISS Research, which provides proxy voting recommendations and analyses, and ISS Corporate Solutions, which provides consulting services to the same issuers and shareholder proponents whose proxies are evaluated by ISS Research. The dual arrangement allows ISS to drive consulting business based on the policies adopted by the research business. In no other area of the federal securities laws is such an arrangement permissible without full and public disclosure.

We recommend the SEC address the problem with proxy advisory firm conflicts of interest by requiring thorough and public disclosure of every conflict of interest. It is insufficient for the disclosures to be made by proxy advisory firms to only their institutional investor and advisor clients. As noted above, the closed nature of this relationship excludes interested and impacted parties like retail shareholders and issuers. Further, the shroud of concealment around specific conflicts can have a negative impact on the market in general.

An effective proxy advisory firm conflict of interest disclosure would be provided in two locations. First, proxy advisory firms should be required to disclose conflicts of interest within each proxy report where a conflict exists. Second, because proxy reports are not public, the disclosures should be made publicly, for example, on a publicly accessible website.

The disclosures should contain enough information for interested stakeholders to identify the involved the conflicted parties, the subject matter and the financial nature of the conflict of interest. Such a disclosure would accomplish three important objectives:

1. The public nature of the disclosure will allow all interested and impacted stakeholders – not just the narrow population of proxy advisory firm clients – to evaluate proxy advisory firm conflicts of interest;
2. The market-driven nature of the disclosure requirement does not require SEC oversight beyond the steps needed to implement the requirement; and
3. The disclosure recognizes the variance in proxy advisory firm business practices and is structured in a manner which does not reveal any proprietary information or act as an industry barrier to entry.

By requiring a disclosure as detailed above, the SEC creates an effective and flexible disclosure regime which allows the disclosure of existing conflicts while also providing an adaptable template for future conflicts of interest which are not yet anticipated.

### **III. Enhance the Proxy Process by Implementing a Mandatory Issuer Review Period for Proxy Reports**

Currently, the proxy advisory firm procedural status quo fails to provide all issuers with needed and reasonable access to draft and final proxy reports. All interested stakeholders, and particularly institutions with a fiduciary proxy voting duty, have an interest in ensuring the veracity of proxy advisory firm draft and final reports. However, the current system fails to provide appropriate guidelines for that review.

The lack of reasonable review time is particularly problematic given the sheer magnitude of data proxy advisory firms must evaluate in a short time frame and the potential for errors and inaccuracies in both draft and final reports. The extremely abbreviated time window – typically 48 hours or less, and often over a weekend -- provides little chance for institutional investors – which must vote tens of thousands of proxies for hundreds of companies – to effectively review underlying data of the proxy reports for accuracy and correct characterizations.

Currently, ISS only provides draft proxy reports to a small segment of companies – those in the S&P 500. No companies outside of that population receive a draft proxy report. Further, ISS does not provide any issuer with the opportunity to preview the final proxy report before it is distributed to ISS's clients. Glass Lewis does not provide any opportunity to view a draft or final proxy report. Instead, issuers can view a draft data-only report – without voting analysis or recommendations. Further, Glass Lewis charges issuers \$5,000 to view a copy of the final proxy report.

The lack of access to review final and draft proxy reports is complicated by the considerable difficulty involved in engaging with proxy advisory firms during proxy season. Thus, providing issuers with a mandatory, prescribed review period for draft and final proxy advisory firm proxy reports should be a required element of the proxy process. Specifically, we recommend the SEC require:

- The draft proxy report be made available to an issuer with a review period of at least five business days; and
- The final proxy report be made available to an issuer with a review period of at least five business days before general publication to a proxy advisor's clientele;

Adding this level of transparency will strengthen the procedural rigor of the proxy process and ensure that votes are cast based on sound information with input from all interested and impacted stakeholders.

#### **IV. Provide Needed Transparency on Institutional Investor Fiduciary Voting and Proxy Advisory Firm Reliance**

Institutional investors and their investment advisors have a fiduciary responsibility to vote in the best interest of their shareholders. The current regulatory framework allows proxy advisory firms to execute the fiduciary activity of proxy voting without any investor review. The result amounts to a delegation of the fiduciary activity, without disclosure, to the proxy advisory firm. This lack of review is particularly concerning given the conflicts of interest and the lack of process also addressed in this letter.

Notably, however, ISS offers institutional investor clients the ability to utilize customized voting policies for the purpose of providing the client with voting recommendations. Using a customized voting methodology, the proxy advisory firm can apply the client's preferences as a supplement or replacement to the proxy advisory firm's methodologies in forming proxy voting analyses and recommendations. The use of customized voting policies provides an investor with the ability to provide a set of customized voting preferences to ISS. This translates to the investor wielding a higher level of control over the voting recommendations and analyses covered by the policies.

There is, however, a lack of transparency concerning what issues are covered by customized voting policies and, to the extent an issue is covered, as to the practical effect of the customized voting policy. Furthermore, whether a fiduciary responsibility can be adequately fulfilled without any investor review is highly questionable.

Given the concerns with proxy advisory firm overreliance and the fact that proxy voting is a fiduciary activity, we recommend the SEC implement a new disclosure requirement for institutional investors that utilize proxy advisory firm voting services. The disclosure would require institutional investors to provide publicly-filed information, including:

- a) Whether the institutional investor and its investment advisor utilize a customized voting policy when engaging proxy advisory firms for proxy voting recommendations and analyses;
- b) If a customized voting policy is used, a *brief* explanation of the proxy issues covered by the policy (*e.g.* "Executive Compensation"); and
- c) The percentage frequency with which the investor voted in unison with the proxy advisory firm on each issue covered by the customized voting policy.

We believe this disclosure achieves two important objectives:

1. Market participants, through a disclosure, can effectively evaluate the "robo-voting" practices of institutional investors *without* the SEC's intervention beyond implementing the requirement. A wide array of stakeholder groups is impacted by proxy advisory firm recommendations and institutional investor voting practices and thus there is a market-wide need and interest in the information included in the disclosure.
2. The disclosure recognizes the need for institutional investors to maintain a cost-effective way to vote thousands of proxies. The SEC could require disclosure after proxy season, alleviating the burden of having to provide the disclosure during the year's busiest time.

**V. Conclusion**

We appreciate this opportunity to provide feedback on the Commission's ongoing effort to streamline the proxy process. If you have any questions about our comments, please do not hesitate to contact me at [heickelberg@exccomp.org](mailto:heickelberg@exccomp.org).

Sincerely,

A large, stylized handwritten signature in black ink, appearing to read 'H. Eickelberg', with a long horizontal line extending to the right from the bottom of the signature.

Henry D. Eickelberg  
Chief Operating Officer

cc: Securities and Exchange Commission:

Hon. Jay Clayton, Chair  
Hon. Hester Peirce, Commissioner  
Hon. Elad Roisman, Commissioner  
Hon. Robert Jackson, Commissioner