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The Honorable Jay Clayton, Chairman
c/o Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File No. 4-725 Proxy Advisor Regulation

Dear Chairman Clayton:

CFA Institute[1] writes to voice our concern about the US Securities and Exchange Commission's ("SEC" or the "Commission") recent guidance regarding proxy advisers (the "Guidance"). We are concerned that the Commission has embarked on an effort to impose greater regulation on the proxy adviser industry, regulation that was neither requested nor seen as needed by clients of firms in that industry.

We are very concerned that the guidance and expected further rulemaking ultimately will increase costs for all investors while setting a dangerous precedent of issuer "preview" of proxy analyses and recommendations. We believe the guidance reflects a fundamental misunderstanding about proxy advisory firms' business models and how investors use their research. By permitting issuers' preview of proxy firms' analyses, the SEC will potentially chill honest advice and opinions, effectively allowing issuers to obstruct the proxy-review process when they disagree with vital and sometimes negative information. The full effect of this, beyond facts already publicly disclosed, will likely be to destroy analyst independence, rig corporate governance, and harm financial market integrity. Importantly, we worry it sets the ground work for harming other independent investment research relationships in the process.

In this letter, we refer specifically to the following SEC actions:

• *Proxy Advisor Guidance*. The Commission's August 21, 2019, Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Guidance Regarding Proxy Voting Responsibilities of Investment Advisers (collectively, the "Guidance"); and

[1] CFA Institute is a global, not-for-profit professional association of nearly 163,000 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 157,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 157 member societies in 73 countries and territories.

- *Proxy Advisor Rulemaking*. The prospect of proposed rule amendments to address proxy advisers' reliance on the proxy solicitation exemptions in Rule 14a-2(b), which is listed in the current Commission Regulatory Flex Agenda.

Increased regulation will impede market-based accountability that is working as intended

Institutional investors constitute the primary group of proxy advisor clients. They hire proxy advisers to act as consultants and analysts with regard to sorting through hundreds or thousands of company proxy statements. This relationship is critical to a) the proper functioning of the corporate governance system, b) the integrity of the proxy-voting process, and c) the quality of stewardship and fiduciary accountability for asset owners. Stewardship and fiduciary accountability for asset managers, in turn, relate to both acting on behalf of and in the best interests of their clients – in this case, voting the shares on behalf of asset owners – and conducting proper due diligence for those votes, including adequate assessment of the opinions expressed by their proxy adviser consultants.

It appears to investors, however, that the Guidance and rulemaking cited above reflect an effort by issuers to retaliate for negative proxy-voting recommendations, or to impede the dissemination of negative views, all in the name of improving process clarity and integrity. For years, calls for further regulation of the proxy advisory industry has come from an issuer community that does not appreciate third-party firms rating their performance. Institutional investors, on the other hand, have found the independence and quality of these ratings as valuable inputs into the due diligence required under their proxy-voting mandates.

It is difficult to understand how the SEC is seeking to increase regulations on entities that rate the performance of equity issuers while, at the same time, it considers ways to a) loosen rules on those same issuers' financial and governance obligations, and b) reduce accreditation restrictions to permit more retail investors to invest in these same companies[2]. In the case of proxy advisers, we strongly believe that the market is working and has worked well for the benefit of fund investors, and that the actions the SEC has taken in support of proxy adviser restraint is contrary to its investor protection and market integrity duties.

Further regulation of proxy advisers will unnecessarily raise costs for investors

One outcome we expect from the SEC's Guidance, an outcome others have expressed, as well, is that the cost of investment management and investment advisory services will rise unnecessarily. These higher costs ultimately will pass-through to investors through lower long-term returns. If there is a need for regulation – if there is a problem – clients in most industries are happy to pay incrementally higher costs to protect their interests. But that is not the case here. The clients of proxy advisers do not see a problem, and therefore see no need for regulation that will only add burdensome costs.

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[2] CFA Institute has expressed support for modifications to rules regarding accreditation, urging recognition of experience and understanding of investment markets as more important than current income and wealth thresholds. At the same time, CFA Institute expressed concern about expanding the definition in a manner that exposes retail and some institutional investors to risks they do not understand. See: https://www.sec.gov/comments/s7-08-19/s70819-6190344-192426.pdf.

If all proxy advisers left the business tomorrow, costs to the institutional investor community and, ultimately, their investors, would rise substantially. These institutions are bound by a fiduciary duty to their clients to research proxies and vote in their best interests. The reviews and analyses proxy advisers provide to their clients serve as important inputs into the voting decisions these institutions must make. Without proxy advisers' inputs, therefore, each institution would have to replicate those reviews and analyses. The additional costs and inefficiencies this would create for institutional investors, their customers, and to the economy, in general, would be significant. Whatever benefits the Commission sees resulting from this Guidance, no doubt they fall well short of the costs they will create for investors and the investment industry.

In addition to increased costs from regulation, the SEC's Guidance appears to set a lower bar for issuers to sue proxy advisers for simple correctable errors. Whether or not this was the intent of the Guidance, it has the potential to hobble proxy advisers' ability to serve their investor clients, to the point of potentially running them out of business altogether. This will have the effect of having government officials choosing which companies and/or industries are permitted to survive and which are destined for failure. We see such Guidance, therefore, as misguided.

This sets a dangerous precedent for analyst independence and issuer retaliation

The Guidance also opens the door to the unwelcome prospect for unnecessary influence in or the watering down, delay, or even prevention of independent third-party ratings by those being rated. By virtue of this Guidance, issuers would have the ability to insert themselves into the process of ratings recommendations before they are delivered to clients.

If implemented, we can see issuers pushing for similar rights in the cases of opinions of investment analysts or credit rating agencies. Institutional investors rely upon the analyses of proxy advisers in much the same ways that they and other investors rely upon sound and independent investment research. When the judgement of these advisory sources was impaired in the past due to a lack of independence, investor trust plummeted along with share prices, pricing multiples, and the overall economy.

CFA Institute worked with other organizations to restore investor trust by ensuring independent, accurate, and proper relations between financial analysts and issuers.[3] Without these safeguards,

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[3] See: CFA Institute Research Objectivity Standards - https://www.cfainstitute.org/-/media/documents/code/other-codes-standards/read-**research-**objectivity-standards.ashx. In particular, analysts should: a) not share with, or communicate to, a subject company prior to publication of any section of a research report that might convey an analyst's proposed recommendation, opinions, rating, or price target; b) implement procedures to ensure a subject company is only permitted to check or verify facts in a research report prior to publication; and c) involve its compliance or legal department in reviewing a draft research report before sections are shared with a subject company, and to approve in advance changes to the research or recommendation resulting from the subject company's verification.

Also see: Analyst/Issuer Guidelines - https://www.cfainstitute.org/-/media/documents/code/other-codes-standards/**analyst-issuer**-guidelines.ashx. Here, issuers are permitted, prior to publication, to: a) review for factual accuracy, and with the analyst's permission, only those portions of an analyst's "report that do not contain or disclose the conclusions, recommendations, estimates, valuations, or price targets;" and, b) ensure that the issuer's management recognizes that any review will be done "only to check factual accuracy of information already in the public domain."

however, review or comment on analyst research reports may be perceived as conflicted by corporate issuers seeking to influence analysts' reports and their conclusions, recommendations, estimates, valuations, or price targets.

The Commission's Guidance and the potential for additional rulemaking may run contrary to these well-articulated best practices and even run afoul of the first amendment by effectively inhibiting the free speech of an actor (a proxy advisor) that another party (issuers) wishes to silence. Said differently, this may go beyond a perception of issuers trying to influence independent financial/proxy analyses, to the possible view that a regulator is helping issuers block or inhibit the presentation of any negative proxy-voting assessments.

This comes from a misunderstanding of how the proxy advisory industry works

The main complaints of the issuer community boil down to the belief that proxy advisers have too much power and that institutional investors unthinkingly accept the views of proxy advisers. In reality, the contrary is true in most relationships between institutional investors and proxy advisers, as the positions of proxy advisers on any issue are built from the aggregated positions of their clients. Proxy advisers develop their positions based on conversations with their clients, from which they learn what clients are thinking or doing on specific issues.

Most institutional investors we talk with have highly sophisticated engagement staffs who are experts on governance issues who take the recommendations of proxy advisers as one input into their own decisions on voting issues, including many that diverge from proxy advisers' recommendations. Institutional investors generally buy the services of proxy advisers for the use of their voting platforms and to use their research as just one input of many as a compliment to their own in-house research.

The main reason that institutional investors vote so often along with the recommendations of proxy advisers is that most votes are routine. Most of these votes relate to uncontroversial matters that involve investors voting along with management. On more controversial topics, however, investors often disagree with proxy advisers and each other, and, as mentioned before, typically have a highly trained team responsible for a detailed corporate governance analysis supporting their positions on any issue.

Conclusions

- As a practical matter, forcing asset owners and investment managers into thinking that they'd have to preclear the proxy analysis and advice with the issuer before it is "safe" to use as a fiduciary will undermine investor confidence and potentially undermine carefully developed standards on other forms of investment research.
- Investors know not to rely solely on a single analyst's recommendation when buying or selling a security. In a similar manner, they employ multiple inputs into investment and proxy decision-making. Nevertheless, the SEC has determined against nearly all round-table advice, that proxy advice is too influential and too heavily relied upon to be trusted – that

investors themselves cannot properly calibrate these factors and therefore, SEC constraints are warranted. That seems a perplexing expansion of the role played by securities regulators.

For these and the other reasons cited above, we urge the SEC to reconsider this Guidance. We encourage further assurance that analyst independence will be preserved, and that issuer retaliation will not be supported. We believe free markets depend on this.

Should you have any questions about our positions, please do not hesitate to contact Kurt Schacht, CFA, [redacted], [redacted], Matt Orsagh, CFA, [redacted], [redacted] or James C. Allen, CFA at [redacted], [redacted].

Sincerely,

/s/ Kurt N. Schacht

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cc: The Honorable Robert J. Jackson, Jr., Commissioner, US Securities and Exchange Commission
The Honorable Allison Herman Lee, Commissioner, US Securities and Exchange Commission
The Honorable Hester M. Peirce, Commissioner, US Securities and Exchange Commission
The Honorable Elad L. Roisman, Commissioner, US Securities and Exchange Commission
William Hinman, Director, Division of Corporation Finance, US Securities and Exchange Commission
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Rick Fleming, Investor Advocate, US Securities and Exchange Commission