



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE DIRECTOR, FINANCIAL REPORTING
AND INVESTOR OPPORTUNITY

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber

August 5, 2010

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Concept Release on the U.S. Proxy System
File Number S7-14-10
RIN 3235-AK43

Dear Chairman Schapiro:

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CMCC") to promote a modern and effective regulatory structure for capital markets to fully function in the 21st century economy. It is an important priority of the CMCC to advance an effective and transparent corporate governance structure. To achieve this objective, the CCMC has called for the elimination of regulatory dead-zones and gaps in regulatory coverage.

With the increased weight of the institutional investor vote and the heavy reliance of institutional investors on proxy advisory firms, the CCMC believes that the lack of transparency, balance, and oversight of proxy advisory firms is a troubling regulatory gap that needs to be addressed. Accordingly, the CCMC believes that the U.S. Securities and Exchange Commission ("SEC") should put in place appropriate supervision to ensure the transparent development of voting policies and issuance of recommendations to prevent disruptions and lack of confidence in the systems governing the election of directors and consideration of shareholder proposals. A failure to address this lack of supervision over proxy advisory firms may lead to the undermining of the corporate elections and annual shareholder meetings leading to adverse consequences upon investors.

Our concerns are listed in more specificity below.

Background

Because institutional investors own a majority of shares in the United States and have a fiduciary duty to vote them, the institutional investor vote has a significant impact on the outcome of corporate elections. In addition, retail investors do not have a similar legal obligation to vote their shares.¹ Because of the number of companies they are invested in, institutional investors will often delegate a proxy advisory firm to develop voting recommendations to fulfill their fiduciary duty to vote. Even before the SEC scaled back broker discretionary voting, studies suggested that proxy advisory firms' recommendations may sway up to 20% of the shareholder vote.² Recommendations of proxy advisory firms are potentially more influential following the SEC's action on broker discretionary voting.

Simply put, in the scope of director elections and consideration of shareholder proposals, proxy advisory firms are a highly influential group that has no regulatory oversight. Indeed recent actions by the SEC and Congress will only increase this influence. Absent reforms to the manner in which proxy advisors set and implement voting policies, such increased influence itself is prone to be out of alignment with the very interests it purports to further. Accordingly, the CCMC believes that it is necessary and appropriate for the SEC to require that proxy advisors adopt and follow operating procedures to provide assurance that the end product is derived from appropriate diligence and objectivity. This will require the development and enforcement of transparency and disclosure to create clearly identifiable rules of the road.

The CCMC believes that proxy advisors may fail to reliably represent the investors they purport to serve for the following reasons:

- **Structural:** Final voting recommendations and voting policies appear to be determined at the sole discretion of proxy advisors firm employees with no set guidelines or parameters. This creates a decision and policy development process that is arbitrary and capricious, potentially harmful to all investors.

¹ The Chamber does have serious concerns regarding retail shareholder participation and will file a separate comment letter with the SEC on proposals to increase retail shareholder participation.

² *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, Jennifer E. Bethel and Stuart Gillan (2002)

This creates opportunities for the vote to become skewed, biased, or misdirected.

- ***Economic:*** Proxy advisors have an economic incentive to standardize and commoditize proxy voting, as a higher quality process that focuses on a vote-by-vote and company-by-company basis demands greater corporate resources. As we all know, the “devil is in the details,” and the risk here is that recommendations are made in a vacuum without diligent consideration of the actual facts and context. In addition, no two companies are exactly alike and accordingly they should not be run in the same way. Unfortunately, economic incentives drive one-size-fits all policy which will not produce better informed investors or managed companies.
- ***Vocal Minority:*** Because of a lack of accountability and transparency, it appears a small vocal group of activists are able to influence the development of voting policies and recommendations of proxy advisory firms. This leads to skewed voting patterns and results. By creating transparent procedures, a more balanced system can be implemented that is more reflective of all investor interests.
- ***Outdated Approach:*** The basic model for providing proxy advice was developed decades ago and has not kept pace with the changing times. Too often, the policy pronouncements fail to be backed up by extensive analysis or how one policy inter-relates with another. The cookie-cutter approach fails to take into account differences on a company-by-company basis. The CCMC believes that the approach should be turned around: The primary focus should be on the company and its industry, and the advisor’s “policies” or other such prescriptions should serve as analytical tools rather than ends unto themselves.

The CCMC proposes that the SEC consider new rules that would directly govern proxy advisors and would have a simple focus: Ensuring that proxy advisors do what they say they are in business to do. Transparency and disclosed operational standards would provide regulators and the public on-going confidence that a proxy advisor actually provides the best possible voting recommendations to its clients. It may be too much to ask that proxy advisors analyze companies in the same holistic, case-by-case manner -- and with the same attention to detail -- as a financial analyst. However, we do believe that the SEC could take simple steps to ensure that proxy advisors have procedures in place that are at the very least reasonably designed to result in quality voting recommendations. Such rules would focus each on the

process for determining voting policies and on the manner in which those policies are implemented.

First, the SEC's rules should require proxy advisors establish and disclose written standards for making recommendations, including policies that are based on statistical and other evidence that is available -- or that may reasonably be deduced. The proxy advisor should be required not only to solicit input from all stakeholders, but also to give that input due and balanced consideration in a transparent manner. The implementation of these procedures, including related internal deliberations, should be transparent so that the public can assess their effectiveness and objectivity, and offer appropriate and timely input.

Second, the SEC's rules should require that a proxy advisor has a process in place that demonstrates due care towards formulating accurate voting recommendations when applied in the unique context of each individual company. It could be similar to the government's use of the Administrative Procedure Act. As with the recommendation standards, this implementation process should be transparent. It should be apparent to the market, including the advisor's own clients, when a recommendation proves correct, and when it proves incorrect. Indeed, one consequence of such transparency might be to encourage proxy advisors to compete with each other based on the *quality* of their voting recommendations.

We are not asking that the SEC prescribe the procedures adopted and disclosed by any given proxy advisor, and indeed we believe that each advisor should remain free to devise its own approach, to experiment with new technologies and concepts. However, those procedures should be transparent and readily understood to give all participants clear rules of the road and create a degree of certainty in the process. Rather, we are asking that the SEC focus on the final product, and require that each proxy advisor does what it is in business to do -- help its clients carry out their fiduciary duties when it comes to proxy voting. This approach is analogous to the procedure that the SEC has taken with credit rating agencies, by adopting rules designed to address concerns about the integrity and transparency of credit rating procedures and methodologies.

There is ample basis for such regulation inasmuch as many proxy advisor activities amount to "solicitations" and as such dependent upon corresponding exemptions from the SEC. For example, Rule 14a-2(b) (3) could be revised to further condition the availability of the exemption provided by that rule. As the courts and the SEC have made clear, fiduciary duty includes not only a duty to disclose or

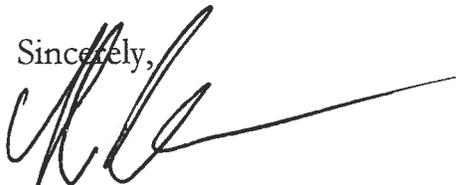
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manage conflicts of interest, but also a duty to ensure that votes are cast with due care.³

Accordingly, the CCMC respectfully requests that the SEC review the practices of proxy advisory firms and take the steps necessary, as outlined above, so they are held to standards of accountability and transparency that will make sure appropriate levels of oversight to insure investors are not improperly influenced or outcomes skewed.

The CCMC will provide more detailed comments on the proxy plumbing release, but because of the increasingly influential role that proxy advisory firm's play in the governance of companies in the U.S., we believe that the issues regarding them should be addressed quickly and on a faster track than other issues contained in the concept release. We stand ready to work with the SEC in this endeavor and look forward to any efforts to insure transparency, accountability, and fairness in proxy advisory firms' role in corporate elections and consideration of shareholder proposals.

Sincerely,



Tom Quadman

CC: The Honorable Kathleen K. Casey, Commissioner, U.S. Securities and Exchange Commission
The Honorable Elisse B. Walter, Commissioner, U.S. Securities and Exchange Commission
The Honorable Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission
The Honorable Troy A. Paredes, Commissioner, U.S. Securities and Exchange Commission

³ See, e.g., *Final Rule: Proxy Voting by Investment Advisors*, Investment Advisors Act Release No. 2106 (Jan 31, 2003) at 2 and note 2; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963) (Interpreting Section 206 of the Advisors Act).