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Congress of the United States
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January 6, 2020

Chairman Jay Clayton
Commissioners Robert Jackson, Jr., Hester Peirce,
Elad Roisman, and Allison Herren Lee
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-0100

Chairman Clayton and Commissioners Jackson, Peirce, Roisman, and Herren Lee:

We are writing to commend you for your recent proposal to amend the rules governing proxy solicitations. We share the view that these rules are an important step towards ensuring "that investors who use proxy voting advice receive more accurate, transparent, and complete information on which to make their voting decisions, in a manner that does not impose undue costs or delays."[1] We are also grateful for the opportunity to comment on this proposal and we are hopeful that the Commission will move swiftly and with care to enact important reforms in this area as part of its tripartite mission to protect investors, ensure orderly and efficient markets, and promote capital formation.

To that end, we would like to pose some questions to the Commission and staff that raise essential considerations as the Commission produces a rigorous cost-benefit analysis of the proposed rule.

Market Power

Though there are many asset managers, only two large proxy advisory firms dominate the industry. There is evidence that proxy advisors' recommendations have a significant impact on asset managers' voting behavior[2] and that proxy advisors' recommendations tend to be correlated.[3]

- What are the costs and benefits of the concentration of market power in just two proxy advisory firms?

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[1] Securities and Exchange Commission, "Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice," Rel. no. 34-87457, available at https://www.sec.gov/rules/proposed/2019/34-87457.pdf

[2] See, generally, C. Alexander, M. Chen, D. Seppi, and C. Spatt, "Interim News and the Role of Proxy Voting Advice," Review of Financial Studies 23 (2010), at 4419-4454; A. Brav, W. Jiang, T. Li, and J. Pinnington, "Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests (2019) (unpublished manuscript)); C. Spatt, Milken Institute Report, *Proxy Advisory Firms, Governance, Market Failure, and Regulation* (2019), *available at* http://milkeninstitute.org/articles/milken-institute-report-calls-oversight-proxy-advisory-firms ("Milken Report").

[3] Milken Report, *supra* n. 2, at 5.

- Are the shareholder voting recommendations of the two major proxy advisors in fact correlated?

Voting Patterns

We are concerned that the current proxy advisor duopoly could have distortive effects on shareholder voting patterns in a manner that does not necessarily reflect the best economic interests of shareholders, including Main Street investors.

- What is the typical quantified impact of a negative recommendation from a proxy advisory firm? How has this impact changed over time?

- Do the shareholder voting patterns of major asset managers tend to align with proxy advisor recommendations? Is the answer different with respect to the voting patterns of smaller asset managers (which one would expect to be more reliant on the recommendations of proxy advisors)?

- Do the voting patterns of smaller asset managers—which one would expect to be more reliant on the recommendations of proxy advisors, for lack of internal resources—differ?

- As an empirical matter, do the voting recommendations of the two major proxy advisors appear to get corporate governance "right" from the perspective of shareholder value, as measured by stock market reaction?

- With respect to the most contentious and controversial shareholder proposals (e.g., "say-on-pay," ESG matters, etc.), does the empirical evidence suggest that the voting recommendations of the major proxy advisors have a consistent political or ideological bias?

Conflicts of Interest

Scholars and market participants have raised questions as to the existence of real or perceived conflicts of interest in connection with proxy advisory services, particularly where a proxy advisor provides both shareholder voting advice and governance consulting services.

- As an empirical matter, does the fact that a proxy advisor provides fee-based governance advice or other consulting services to a public company have any predictive effect with respect to the shareholder voting recommendations issued with respect to the same public company?

- As an empirical matter, does the ownership structure of a proxy advisor have any predictive effect as to either the shareholder voting recommendations or consulting services that the proxy advisor provides?

- Credit rating agencies and public auditing firms are subject to significant regulation and supervision by the SEC, particularly in the realm of mitigating real or perceived conflicts of interest. By contrast, proxy advisory firms are subject to comparatively less stringent regulation. Is there a compelling reason for this difference in approach, given the importance of each of these three industries in maintaining our capital markets?

- To what extent would the following policy proposals serve to mitigate real or perceived conflicts of interest?
    - Separation of voting recommendation services from consulting services
    - Transparency and disclosure of consulting client lists
    - Disclosure of proxy advisor cost-benefit analyses underlying their voting recommendations

Informational Errors

Public companies and the U.S. Chamber of Commerce have raised concerns regarding the incidence of factual errors in the information provided by proxy advisor firms to asset managers, alleging that these errors have had deleterious effects on share prices.

- What does the empirical evidence suggest as to the prevalence of factual errors in proxy advisory services?

- Observers have also complained that factual and analytical mistakes in proxy advisor reports are difficult to correct, resulting in the dissemination of "bad" information to market participants. Proxy advisors are not currently required to provide a public justification of their reasoning. Would the potential for such mistakes be reduced if proxy advisors were required to disclose the justifications for their recommendations? Would the ability of public companies and other stakeholders to correct misinformation be improved by requiring such disclosure?

Thank you again for your hard work on this important issue and for your recent proposals. We look forward to working with you to support your efforts to protect investors, ensure orderly and efficient markets, and promote capital formation.

Sincerely,

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