Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number S7-22-19

January 21, 2020

Dear Ms. Countryman:

I would like to provide comments in support of the proposed Securities and Exchange Commission amendments to its rules governing proxy advisor firms. The proposed rules would be a positive step forward in dealing with a number of problems with the current use of proxy advisor firms, particularly their use by institutional investors.

Shareholder governance of corporations is founded on the idea that owners of the corporation should have a voice in how the corporation is governed. Corporations hold stockholder meetings to provide the opportunity for stockholders to vote on issues of importance, such as mergers and acquisitions or members of the board of directors. However, the vast majority of retail investors are surely aware of the low probability that their particular vote will determine the outcome. As I noted in an earlier comment with regard to the SEC roundtable on the proxy process, there are an excess of 1.4 billion shares of General Motors stock outstanding so a retail investor with as many as 5,000 shares would not be likely to bother to attend a meeting to cast their vote. The use of proxies is one response to this, however, even with on-line proxy voting the opportunity cost of determining what is the best way to cast one's ballot is so significant that retail investors are not likely to vote their own shares.

Institutional investors have much larger numbers of shares and are more likely to vote their proxies and thus have a very large influence on corporate governance. As the SEC noted in the introduction to its proposed rules, institutional investors have become so large that they now own about three-fourths of the market value of U.S. public companies. How institutional investors vote their proxies obviously is very important to how corporations are run.

Institutional investors may own shares of hundreds of different companies, and the time and expense of determining how to vote on the myriad of issues that will best serve the interests of the mutual fund shareholders or pensioners will be extremely large. Proxy advisory firms can serve as a way to resolve this problem for institutional investors. The proxy advisory firm can take on the mechanics of voting large numbers of shares of numerous different companies as well as research particular issues. However, the development of such firms has met with a number of problems of which the SEC is aware and which the new rules begin to address.

One major problem is the principal-agent problem that I addressed in my earlier comments. Institutional investors, as would be expected, are strongly influenced by the advice given by proxy advisory firms, as has been found in empirical studies. It would be odd for an institutional investor to solicit advice from a proxy advisory firm in order to reduce the cost of voting proxies and then have enough information to decide that the proxy advisory firm's recommendations were not in the best interest of the institutional investor.

Indeed, several studies have shown the reliance on proxy advisor recommendations is extensive. For example, as I noted in my earlier comments, a paper by the American Council for Capital Formation that found that 175 firms with more than $5 trillion in assets under management followed ISS' guidance over 95% of the time between July 2012 and 2018 and 82 asset managers with over $1.3 trillion in assets voted with ISS's recommendations 99% of the time.[1]

At issue, then, is whether the interests of the proxy advisor firm are consistent with the interests of the investor. It is certainly possible that the proxy advisor firm has its own interest in the outcome of the ballot and it is for this reason that the advice is being offered.[2]

Given that the proxy advisor business is essentially a duopoly, it is difficult for institutional investors to seek out multiple proxy advisor firms and compare the adequacy of the proxy firm's advice. Additionally, the lack of market competition could be what drives these firms to produce one-size-fits-all recommendations. It is thus important for the SEC to ensure proxy advisor firms are acting in the interest of the investors seeking their advice. The proposed rules that require proxy advisor firms to disclose information, such as revealing conflicts of interest and providing details about the accuracy and depth of information used in coming to the advice, will assist institutional investors in determining whether the advice is likely to improve the financial return to shareholders – what should be these fund's top priority.

Institutional investors will generally be concerned with maximizing returns. This is because individual shareholders in Vanguard 500 Index Fund, for example, are not knowledgeable about the proposals for any Vanguard 500 holding, such as 3M company, nor can they choose to vote their proportional share even if they were knowledgeable. It is thus likely that shareholders are primarily, if not solely, concerned with approving those proposals that enhance the shareholder equity. As Vanguard will have to compete with other mutual funds, it is important that Vanguard know whether its proxy advisor firm is providing advice that will enhance the value of the corporations held by Vanguard.

It is also important that individual corporations be able to know that the proxies are being voted on are using accurate information. The SEC proposals that "(i) facilitate improved dialogue among proxy voting advice businesses and registrants and certain other soliciting persons

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[1] Timothy M. Doyle, *The Realities of Robo-Voting*, American Council for Capital Formation (November 2018): http://accfcorpgov.org/wp-content/uploads/ACCF-RoboVoting-Report_11_8_FINAL.pdf.

[2] An example would be if the proxy advisor firm has a political interest in ESG investing as discussed in Benjamin Zycher, American Enterprise Institute, "Other people's money: ESG investing and the conflicts of the consultant class; Doing well while pretending to do good, " December 17, 2018, https://www.aei.org/publication/other-peoples-money-esg-investing-and-the-conflicts-of-the-consultant-class/

(including certain dissident shareholders) before the advice is disseminated to clients of the proxy voting advice business and (ii) provide a means for registrants and certain other soliciting persons to communicate their views about the advice before the proxy voting advice businesses' clients cast their votes"[3] will allow the individual corporations to correct errors or misrepresentations. This is important to efficient corporate governance and overall capital formation.

It is particularly important for pension fund managers to be able to accurately ascertain the accuracy of proxy advisor advice. While it is possible for a mutual fund investor to move their investment to another mutual fund if the mutual fund's holdings are not performing well relative to other mutual funds, individual pensioners cannot do so. A CALPERS pensioner, for example, is affected by the performance of the holdings of CALPERS, and has no mechanism to respond to underperformance. Taxpayers in general are also affected by underperformance. Pension Tracker, a project of the Stanford Institute for Economic Policy Research, has estimated the total unfunded pension liabilities of state and local governments to be in excess of $5 trillion.[4] It is vitally important that pension fund managers have clear and accurate information about how to vote proxies in a manner that enhances the value of their holdings. The SEC proposed rules move in that direction and thus should be supported.

It is also of importance that institutional investors not be able to satisfy fiduciary responsibility and avoid conflict of interest simply by following the advice of a proxy advisory firm. As noted above, proxy advisory firms can easily have conflicts of interest as well and may have other motivations than enhancing shareholder value. Nor should it be necessary for an institutional investor to follow the advice of a proxy advisor firm, since the investor may have sufficient knowledge about a particular corporation to not need outside advice. Requiring the use of proxy advisory firms expands the power of the proxy advisor duopoly and limits the incentive for institutional investors to develop their own knowledge of corporate governance.

The SEC is to be commended in its acknowledgement of problems in the proxy advisor system and the proposed rules move in the direction of providing a solution to these problems.

Sincerely,

Dr. Gary Wolfram
William Simon Professor of Economics
Hillsdale College

[3] Securities and Exchange Commission, 17 CFR Part 240, RIN 3235-AM50, page 44

[4] https://www.forbes.com/sites/chuckdevore/2019/05/31/5-2-trillion-of-government-pension-debt-threatens-to-overwhelm-state-budgets-taxpayers/#487e505b759d