INSTITUTE FOR
Pension Fund
Integrity

January 27, 2020

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Dear Ms. Countryman:

On behalf of the Institute for Pension Fund Integrity am submitting comments in response to the Securities and Exchange Commission's (SEC) Notice of Proposed Rulemaking S7-22-19 and S7-23-19 published in the Federal Register on November 5, 2019, to express my strong support for the proposed changes regarding proxy advisory firms. The time to rein in the outsized influence of proxy advisory firms is long overdue. The proposed rules address numerous problems in the proxy advisory process, such as lack of transparency, conflicts of interest, and vulnerabilities to outside influence. The forthcoming changes will better position institutional investors – such as public pension funds – to prioritize their fiduciary duties while also affording them the option to use proxy advisor services as necessary, with greater confidence in their recommendations. The SEC should finalize rules S7-22-19 and S7-23-19 to implement reforms on proxy advisory services that will prohibit robo-voting, scrutinize specialty reports, and require proxy advisors to disclose their conflicts of interest with the SEC. To further support and explain the rationale for reform, the Institute for Pension Fund Integrity (IFPI) has published an issue brief[1] on SEC rulemaking and how these rules, in particular, stand to address major shortcomings in the proxy advisory process. It is enclosed here for the SEC docket.

IPFI is an organization based in Arlington, VA that seeks to ensure that local, state, and federal leaders are held responsible for their decisions pertaining to pension fund investments. We work to increase awareness on how these funds are managed and performing in light of politically-motivated investment trends. A fuller summary of my thoughts on the matter can be found on *Forbes*.[2]

My background affords me a thorough understanding of all aspects of fund management. I was formerly State Treasurer of Connecticut and, before that, a member of that state's House of Representatives. I was Vice Chairman and Managing Director of Deutsche Bank's asset management division. I also served as Under-Secretary-General of the United Nations for Management and Chief Financial Officer of the U.S. State Department. I also headed PIMCO's largest equity management subsidiary and am the founder of Cambridge Global Capital, a venture capital company focused on life sciences, artificial intelligence, and data.

The current rule proposals signify a commendable regulatory effort to curb the present duopoly in the proxy advisory firm market as well as the abuses of power inherent in that system. Institutional Shareholder Services

[1] http://ipfiusa.org/wp-content/uploads/2020/01/SEC-RULEMAKING-AND-WHAT-IT-MEANS-FOR-PROXY-ADVISORY-FIRMS.pdf
[2] https://www.forbes.com/sites/christopherburnham/2019/11/04/take-politics-out-of-public-pension-plans/#16bc63d55785

Inc. (ISS) and Glass Lewis & Co. currently dominate roughly 97% of the proxy advisory firm market share.[3] IPFI published an issue brief on this very problem.[4] From uptick in shareholder resolutions in 2004 until the passing of the Dodd-Frank Act in 2010, proxy advisory firms and investors who neglected their fiduciary duties through their reliance on these firms enjoyed repeated uses of get-out-of-jail-free cards as they blindly followed activist investing recommendations.

First and foremost, proxy advisory firms offer insufficient transparency on their methodology. This is a disservice to shareholders and company executives who seek to understand the rationale behind a vote's outcome. By withholding information on the basis for their recommendations, proxy advisory firms avoid specific scrutiny for any particular voting outcome. Registered funds are required to disclose a fund's proxy voting record, and public companies provide ample disclosures on potential conflicts of interest.[5] Yet, aside from general voting guidelines, proxy advisors do not disclose their methodology for their analyses and recommendations. They also protect their client list from public scrutiny. Such an opaque apparatus offers little assurance to 14 million+ pension plan members who have no choice but to hand over their retirements to these firms.

Furthermore, the blatant conflicts of interest that have flourished amidst this scheme are shameful. Proxy advisory firms not only offer their analytical services to investors but also advise companies on how to navigate the voting process. Proxy advisory firms dole out ratings to indicate a company's reliability and offer consultation on how to improve those ratings. The Sarbanes-Oxley Act of 2002 requires the separation of parts of financial institutions that provide ratings on companies and those that conduct advisory work for those same companies.[6] The aforementioned violation serves as a testament to both the arrogance of these industry titans and the lack of rules and enforcement measures capable of rectifying this transgression.

It is apparent that proxy advisory firms are well-practiced when it comes to prioritizing financial returns internally. Yet they fail to apply the same, singular objective when formulating their recommendations. This is evidenced through the use of tailored reports known as "specialty reports,"[7] including Socially Responsible Investment (SRI) Proxy Voting Guidelines, Faith-Based Proxy Voting Guidelines, and Sustainability Proxy Voting Guidelines. These guidelines give preference to resolutions centered around religious, environmental, and social causes, independent of the effect these initiatives may have on fiscal performance.

While it is perfectly fine for an individual or retail investor to use his or her funds to rear some personal moral and/or political agenda, the reality is that this demographic makes up a small portion of total shareholders. Institutional investors—such as those overseeing mutual funds, index funds, pensions, and hedge funds on behalf of others—own 70% of the outstanding shares of publicly traded corporations in the United States.[8] They also exhibit significantly higher voting participation rates, casting votes that represent 91% of the shares that they hold compared with only 29% for retail investors.[9]

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[3] https://www.wsj.com/articles/companies-target-firms-that-advise-shareholders-11552987800
[4] http://ipfiusa.org/wp-content/uploads/2019/09/REFORMING-THE-PROXY-ADVISORY-FIRM-DUOPOLY_An-Analysis-of-Recent-SEC-Guidance-and-Its-Implications-for-Public-Pension-Retirees.pdf
[5] https://www.blackrock.com/corporate/literature/publication/sec-roundtable-proxy-process-111618.pdf
[6] https://www.congress.gov/bill/107th-congress/house-bill/3763/text
[7] http://accf.org/2019/07/16/proxy-firms-independence-is-undermined-by-their-own-shadow-reports/
[8] https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/
[9] Ibid.

Institutional investors represent diverse pools of contributors who, very likely, possess diverse beliefs and opinions. However, they share a uniting goal of increasing financial returns on their managed-investments. The proposed rules directly affect this problem area by increasing resolution thresholds from 3%, 6%, then 10% over three successive years to 6%, 10%, then 30%. This measure restores power to a greater portion of shareholders who will be financially-affected by these resolutions.

Building on the sentiments expressed in the interpretive guidance released on August 21, 2019, the proposed rules codify desperately-needed investor protections that are vital to the financial well-being of the tens of millions of individuals whose dollars fall under the umbrella of proxy advisory firms. The proposed rules:

1. Ensure accuracy and correct misinformation by allotting companies an extended review window to assess information referenced and disseminated by proxy advisory firm reports.
2. Block the passing of outlier resolutions through increased shareholder consensus requirements.
3. Prevent external parties from hijacking the shareholder voting process to advance moral, social, and/or political agendas to the detriment of corporate financial performance.

Conclusion

For the reasons detailed in these comments regarding the improvements that the proposed rules will afford to the shareholder resolution and the proxy voting processes, I am in strong favor of Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice and Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8.

In tandem with the latest interpretive release clarifying that proxy advisory firms are subject to anti-fraud measures, this rule would bestow a dose of integrity to the proxy voting process. By reducing the number of contentious, outlier resolutions passed by a small minority, this rule also aids corporate harmony, which contributes to the overall fiscal health of our markets.

It is telling that CEO of Institutional Shareholder Services Gary Retelny and billionaire activist investor Carl Icahn have been two vocal opponents of the SEC's efforts. Neither of these individuals represent the 14 million+ Americans who count on stable, proven returns on their humble contributions to their retirements.

I urge that the proposed rules take effect as soon as possible. Under current policy, the outsized influence of proxy advisory firms has risen astronomically. By containing these industry giants, the SEC will foster an environment in which the corporate sphere can capitalize on practical, economic pursuits rather than succumb to disparate, open-ended resolutions leading to questionable financial outcomes.

Thank you for the opportunity to submit comments on the Notice of Proposed Rulemaking Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice and Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8. Please do not hesitate to contact me to provide further information

Sincerely,

Christopher Burnham
President
Institute for Pension Fund Integrity
Washington, DC

SEC RULEMAKING AND WHAT IT MEANS FOR PROXY ADVISORY FIRMS

Assessing the Implications of Proposed Rules S7-22-19 and S7-23-19

January 2020

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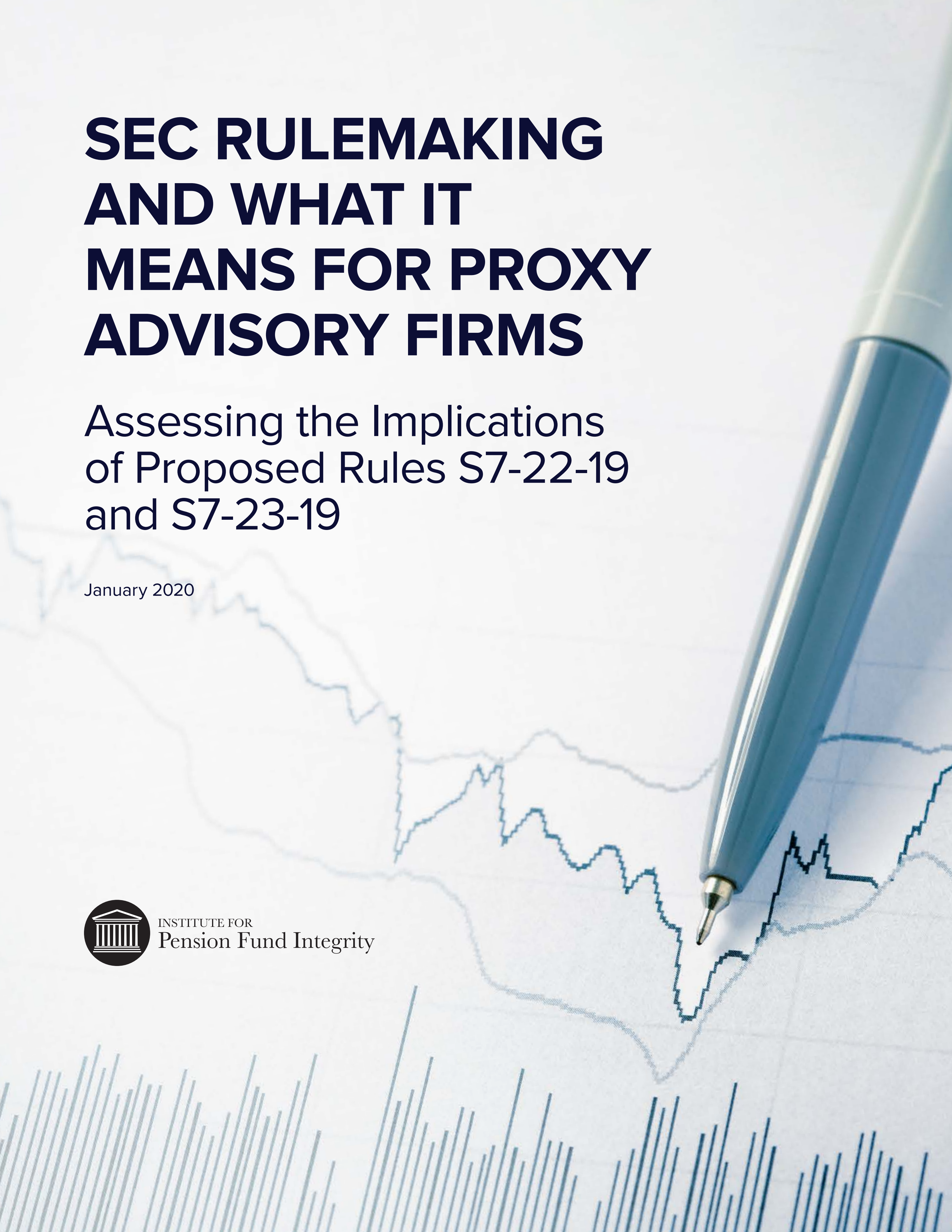

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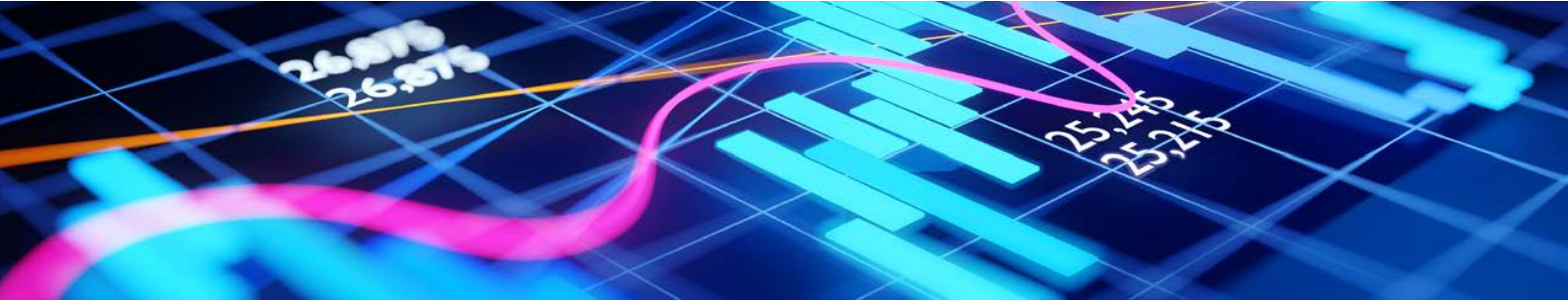

EXECUTIVE SUMMARY

The SEC's mission consists of three objectives: inform and protect investors; enforce federal securities laws, and facilitate capital formation. To keep pace with the ever-changing landscape of our markets, the SEC updates regulations by following emerging trends. One such update is taking place right now. The SEC recently announced proposed rules aimed at addressing the outsized influence of proxy advisory firms and restoring much-needed protections to the proxy voting process and those who bear the financial consequences of the decisions made throughout.

The proposed rules stand to correct a number of issues related to proxy advisory firms that compromise the shareholder voting process, and therefore company performance and financial returns on public pension investments. These include:

1. **Lack of transparency** - Those interested in obtaining information on the basis of proxy voting recommendations will find it nearly impossible. Furthermore, proxy advisors provide a technological platform for fund managers to utilize.[1] This encourages compliance with recommendations in a closed system, resulting in a practice of "robo-voting." This phenomenon disenfranchises public pension plan members from having a say over how their own investment dollars are allocated.

2. **Conflicts of interest** - Proxy advisory firms advise institutional investors on how to cast their votes. These firms also advise companies on how to obtain a more favorable score as awarded by the proxy advisory firm. Such a practice directly violates the Sarbanes-Oxley Act of 2002, which requires the separation of parts of financial institutions that provide ratings on companies and those that conduct advisory work for those same companies.[2]

3. **Politically-motivated voting -** In addition to the Taft-Hartley voting guidelines, which prioritize financial returns, proxy firms deploy a range of specialty reports to inform institutional investors on how to vote, including socially responsible, faith-based, and sustainability guidelines. These guidelines allow for third parties to hijack pension funds in an attempt to advance arbitrary political or social causes while providing cover for the proxy advisory firms who have been entrusted with providing independent recommendations. Recommendations that give weight to any of the above considerations are far from independent.

4. **Outsized and Unwieldy Influence** - *Institutional Shareholder Services Inc.* and *Glass Lewis Co.* control 97% of the market. The voting policies of these firms have become so enormous that corporations have adopted a practice of tailoring their policies in advance to avoid lengthy "vote no" campaigns.[3]

All regulation amendments must follow the procedures of the official rulemaking process. Because an informed citizen base is the best way to ensure democratic participation in these events, the Institute for Pension Fund Integrity has produced this issue brief on the official SEC rulemaking process for the SEC docket. We aim to educate the public and key officials on the rulemaking process, why it matters to individuals outside the corporate or regulatory space, and why the SEC should follow through on their proposed rules.

1 https://youtu.be/b1iO5RzP1QE?t=3523
2 https://www.congress.gov/bill/107th-congress/house-bill/3763/text
3 https://m.lw.com/thoughtLeadership/influence-of-iss-and-glass-lewis-on-proxy-advisory-business

SEC MANDATE

Before the introduction of securities regulations, companies often issued false or misleading statements about the securities they were issuing.[4] To restore the public's faith in the integrity of the securities market, Congress passed the Securities Act of 1933, followed by the Securities Exchange Act of 1934, which officially created the SEC. The rulemaking process plays a vital role in all three divisions of the SEC mission by offering a roadmap to address shifting trends or identified weaknesses in the regulatory matrix. Several key acts, known as the Federal Securities Laws, give the SEC the authority to issue rules.

> "The rulemaking process plays a vital role in all three divisions of the SEC mission by offering a roadmap to address shifting trends or identified weaknesses in the regulatory matrix."

Investment Company Act of 1940: This act regulates companies that primarily engage in investing, reinvesting, and trading securities. It requires that companies routinely disclose their financial condition and investment policies to investors.

Investment Advisers Act of 1940: This law requires that firms or sole practitioners be compensated for advising others about securities investments must register with the SEC and conform to regulations designed to protect investors.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010: This law reshaped the SEC by expanding its regulatory abilities in areas including but not limited to: consumer protection; trading restrictions; credit ratings; regulation of financial products; corporate governance and disclosure, and transparency.

4 https://www.investopedia.com/terms/s/sec.asp

CURRENT RULEMAKING AGENDA: PROXY ADVISORY REFORM

The rulemaking process is not bound to a set date or season every calendar year. Rather, the SEC places items on its agenda continually. As these agenda items fluctuate in impact and priority, they may cross a threshold where they demand action. The rules proposed on November 5th, 2019 represent the most concrete step in a process that has been taking place for years. Former SEC Commissioner Dan Gallagher cites the poor quality of proxy advisory firm recommendations and blatant conflicts of interest as the top complaints that companies and trade associations make to the SEC Commission.[5] During Mr. Gallagher's time on the Commission, Staff Legal Bulletin No. 20 marked an attempt to resolve this by clarifying that proxy advisory firms had an affirmative duty to disclose conflicts of interest.[6] Several years later, the SEC held a roundtable on the proxy process and rules on November 15, 2018.[7] Then, on August 21, 2019, the SEC Commissioners issued interpretive guidance (which IPFI covered extensively in a previous issue brief).[8]

The current proposed rules, passed by a vote of 3-2, build on the sentiments expressed in the interpretive guidance. These rules would codify desperately-needed investor protections vital to the financial well-being of the millions of individuals whose dollars fall under the umbrella of proxy advisory firms. The rules seek to limit the role of proxy advisory firms in two ways. First, they require proxy adviser firms to give companies two chances to review proxy voting materials before they are sent to shareholders.[9] This effort responds to calls for stricter adherence to accurate information on the part of proxy advisory firms. With two opportunities to review reports, companies would have a chance to point out inaccuracies or outdated assertions.

> “Proxy advisory firms also utilize a variety of benchmark reports that award priority to objectives outside the scope of financial returns. ISS drafts five different specialty reports that allow advisors to make recommendations skewed towards arbitrary causes and away from profits.”

5 https://www.youtube.com/watch?v=b1iO5RzP1QE&feature=youtu.be&t=2080
6 https://www.sec.gov/interps/legal/cfslb20.htm
7 https://www.sec.gov/news/press-release/2018-206
8 http://ipfiusa.org/wp-content/uploads/2019/09/REFORMING-THE-PROXY-ADVISORY-FIRM-DUOPOLY_An-Analysis-of-Recent-SEC-Guidance-and-Its-Implications-for-Public-Pension-Retirees.pdf
9 https://www.ft.com/content/778602a8-f6b1-11e9-a79c-bc9acae3b654

The rules also mandate an increase in the resubmission thresholds for motions that shareholders file at companies. These issues span a broad spectrum, ranging from executive compensation to climate change disclosures. The thresholds determine what level of shareholder support is needed to keep a proposal alive. Under current provisions, shareholder resolutions must gain 3%, 6%, and then 10% approval over three successive years to meet a passing verdict. The latest proposed rule suggests increasing those percentages to 6%, 10%, then 30% over three successive years. The proposed rule seeks to reach a greater consensus among shareholders who will be financially-affected by these resolutions.

Institutional Shareholder Services (ISS) retaliated by suing the SEC just ahead of the proposed rules' official announcement. CEO Gary Retelny asserted that, "the SEC inappropriately altered the regulatory regime applicable to the voting advice provided by proxy advisory firms and that the new interpretation is unlawful."[10] As IPFI has outlined in this brief, the SEC organized numerous events to gather opinions from stakeholders across the board on this issue before issuing guidance and now rule proposals. These sessions informed the proposed rule and demonstrate that, despite ISS' claims, plenty of affected stakeholders see the utility for such rules. Now, the masses have a chance to weigh in against proxy advisory firms' corporate interests.

This isn't the first time the SEC has faced pushback from its proposed rules. The "Regulation Best Interest: the Broker-Dealer Standard of Conduct" rule proposal attempted to eliminate conflicts of interest when financial advisors make investment recommendations to clients.[11] The rule drew ire from leading congress members, and Congress even added a bill amendment to prevent the implementation of the regulation. Rules have a tendency to spark debate, which is why the SEC relies on public comments to assist them in making a decision. Reg BI garnered 3,783 comments in the year-long public comment period.[12]

10 https://www.ft.com/content/cdcb6ed7-18f4-4729-8dc4-6a577ac44f15

11 https://www.politico.com/story/2019/06/05/warren-waters-blast-sec-financial-advice-rule-as-wall-street-cheers-1507335

12 https://www.sec.gov/comments/s7-07-18/s70718.htm

ACTIVIST INVESTING, ROBO-VOTING, AND CONFLICTS OF INTEREST

The public comment period serves a critical purpose in the rulemaking process by providing a forum for affected stakeholders to make their case. At IPFI, our sole mission remains safeguarding the retirements of over 14 million Americans who currently contribute to a public pension plan. The degree to which proxy advisory firms have acquired de facto authority over how public pension funds perform is often obscured to those plan members. Shareholder resolutions introduce rules and guidance that have the potential to impact a company's bottom line. When resolutions become a vehicle for activist investing or other stipulations that threaten a company's profits, proxy advisors are the ones who award their approval--not the plan members who are directly affected by the outcome.

The total amount of activist campaigns (also known as environmental, social, and governance [ESG] investing) introduced through shareholder resolutions has hovered between 250-300 per year for the past five years.[13] IPFI has previously written at length about the merits and pitfalls of ESG investing. We maintain that, in its purest form, ESG investments can add value and reduce risk in an investment

> “When resolutions become a vehicle for activist investing or other stipulations that threaten a company's profits, proxy advisors are the ones who award their approval—not the plan members who are directly affected by the outcome.”

portfolio and there are cases in which ESG investment would be prudent. However, ESG investment measures have become increasingly politicized through institutional investors and pension funds' growing reliance on proxy advisory firms, and have been shown to weaken public pension fund performance in California, New Jersey, New York, Illinois, and elsewhere.[14]

In particular, the practice of robo-voting, or automatic voting, should concern plan members (as well as any individual who has entrusted his or her investments to a third-party advisor). Robo-voting has become a staggering issue among institutional investments, and it occurs when investors and money managers offload their voting responsibilities to proxy advisory firms. While the purpose of proxy advisory firms is to inform investors, recent studies have shown that investors often automatically vote in-line with the recommendations they receive. In fact, one study demonstrated that asset managers overseeing over $5 trillion in assets followed the recommendations of ISS over 95% of the time.[15] A 2018 list of the 20 top robo-voting entities includes five different pension funds.[16]

13 https://corpgov.law.harvard.edu/2019/04/05/review-and-analysis-of-2018-u-s-shareholder-activism/
14 http://ipfiusa.org/wp-content/uploads/2018/09/IPFI-ESG-Paper.pdf
15 https://corpgov.law.harvard.edu/2018/11/29/the-realities-of-robo-voting/
16 Ibid.

> Robo-voting disenfranchises those individuals who have entrusted institutional investors with their funds on the premise that those investors would grow their returns through careful analysis, not subject those funds to an array of social, moral, or political factors that may not align with strictly fiduciary considerations.

The timeframe within which investors cast their votes after receiving recommendations demonstrates that, in many cases, the recommendations are not being carefully subjected to the tenants of fiduciary responsibility which demands a thorough level of due diligence on the investor's part. One study found that almost 20% of votes are cast within three days of an adverse recommendation.[17] The study also addresses the problem of faulty recommendations made by proxy advisory firms. When issuers believe proxy advisors have made a faulty recommendation, they may file a supplemental proxy filing. A review of filings from 94 different companies from 2016 through September 2018 showed 139 significant problems, including 49 that were classified as 'serious disputes.'[18] Naturally, robo-voting perpetuates the financial costs associated with faulty recommendations.

On the topic of faulty recommendations, proxy advisory firms also utilize a variety of benchmark reports that award priority to objectives outside the scope of financial returns. ISS drafts five different speciality reports that allow advisors to make recommendations skewed towards arbitrary causes and away from profits. Only one of these reports, the Taft-Hartley guidelines, provides a basis for recommendations strictly in-line with fiduciary responsibility. By contrast, the other guidelines abdicate fiduciary responsibility in favor or social, moral, or political inclinations. These shadowy alternative recommendation standards include Socially Responsible Investment guidelines, Faith-Based guidelines, and Sustainability guidelines. Proxy advisory firms offer pick-and-choose services to their clients while providing cover as independent third parties.

In conjunction with the existence of numerous investment guidelines utilized by ISS, robo-voting amounts to negligence. This practice disenfranchises those individuals who have entrusted institutional investors with their funds on the premise that those investors would grow their returns through careful analysis, not subject those funds to an array of social, moral, or political factors that may not align with strictly fiduciary considerations.

Furthermore, proxy advisory firms offer little in the way of reassurance to pension plan members. These firms consistently oppose any regulatory measures that seek to remedy the blatant conflict of interest inherent in the proxy advisor business model. The core problem lies in their practice of providing advice to institutional investors on how to vote while also advising corporations on how to improve their corporate governance. Firms like ISS also provide a rating on corporations, which is affected by that company's corporate governance. The Sarbanes-Oxley Act of 2002 requires the separation of parts of financial institutions that provide ratings on companies and those that conduct advisory work for those same companies.[19]

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17 https://corpgov.law.harvard.edu/2018/11/29/the-realities-of-robo-voting/#11
18 Ibid.
19 https://www.congress.gov/bill/107th-congress/house-bill/3763/text

CONCLUSION

As we have seen many times before, what began as a market issue that rightfully fell under the SEC's purview has become a polarizing political circus. As it turns out, proxy advisory firms played a substantial role in this shift as they aggressively lobbied Congress in defense of the status quo—an unregulated free-for-all in which they could reap profits that would otherwise be hindered by stricter rules and guidance.

> “With the recent vote to propose rules on proxy advisory firms, the SEC is fulfilling its three core objectives: inform and protect investors; enforce federal securities laws, and facilitate capital formation.”

The SEC is a critical federal agency that has worked for the past 85 years to protect investors, increase financial transparency, and maintain the stability of the United States economy. The agency's rules and regulations are meant to reflect these values. With the recent vote to propose rules on proxy advisory firms, the SEC is fulfilling its three core objectives: inform and protect investors; enforce federal securities laws, and facilitate capital formation.

To make an accurate assessment when drafting its final rules, the SEC relies on the voices of the people to guide it on subsequent steps. IPFI encourages each and every citizen to participate in this rulemaking process to help safeguard the retirements of over 14 million public servants.

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