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Filed Electronically

January 31, 2020

Ms. Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice;
File No. S7-22-19

Dear Ms. Countryman:

Institutional Shareholder Services Inc. (ISS) submits these comments in response to the above-referenced proposal to regulate proxy advice as a proxy solicitation under the Securities Exchange Act of 1934 (Exchange Act).[1]

Over the past several years, proxy advisers have become surrogates in the debate over how much say shareholders should have in the companies they own. On one side of this debate are shareholders and their representatives, who see proxy voting as an integral part of their fiduciary responsibilities and a duty of good corporate citizenship and who believe proxy advisers play a critical role in aggregating and synthesizing the vast array of data found in proxy statements and providing independent research, analysis and advice that help shareholders make well-informed voting decisions. On the other side are certain corporate representatives who appear to resent shareholders' ability to disagree with management and who have launched a volley of attacks against proxy advisers based mostly on anecdote, faulty reasoning and the occasional fabricated news. In issuing the current rule proposal, the SEC has put its finger firmly on the issuers' side of the scale, a departure from its stated mission. Distilled to its essence, the proposal would give the managers of U.S. public companies an unprecedented and unconstitutional editorial role in the production of the research and vote recommendations that institutional investors engage proxy advisers to provide.

The proposal has three core components.

The first is a definitional component. Here, the Commission proposes to amend Exchange Act Rule 14a-1(*l*) to classify expert proxy voting advice, including advice rendered by investors' fiduciaries, as a "solicitation" subject to the Exchange Act proxy rules, depending on how the adviser markets its services and structures its fees. The proposed changes to Rule 14a-1(*l*) would codify a modified version of the new definition of solicitation the SEC adopted this past August when it issued an "Interpretation and Guidance" regarding proxy advisers.[2] Concluding that the SEC lacks the

[1] *Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice,* Exchange Act Rel. No. 87457 (Nov. 5, 2019), 84 Fed. Reg. 66518 (Dec. 4, 2019), available at https://www.sec.gov/rules/proposed/2019/34-87457.pdf.

[2] *Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice,* Exchange Act Rel. No. 86721 (Aug. 21, 2019), 84 Fed. Reg. 47416 (Sept. 10, 2019), available at https://www.sec.gov/rules/interp/2019/34-86721.pdf (Interpretation and Guidance).

authority to regulate proxy voting advice as though it were a solicitation, ISS has asked a federal court to invalidate the Interpretation and Guidance on both substantive and procedural grounds.[3]

The second component of the proposal is exemptive. Here, the Commission proposes to amend two exemptions from the information and filing requirements of the proxy solicitation rules. One exemption, found in Rule 14a-2(b)(1), was originally designed for certain shareholders and other parties who do not seek to act as a proxy for a security holder and who have a limited interest in the outcome of a shareholder vote, consent or authorization. The other exemption, found in Rule 14a-2(b)(3), was designed for certain financial advisors who voluntarily supply proxy voting advice to parties who have not asked for it, which the SEC traditionally has called "unsolicited" advice. Under the current proposal, a proxy adviser seeking to rely on either exemption would be required to provide the subject of its advice with a review and feedback right, the timing of which would vary depending on when the company files its definitive proxy statement. In addition, no later than two business days prior to delivery of the proxy advice to its clients, the proxy adviser would be obliged to provide the subject of the research and advice with a final notice of voting advice, which would have to contain a copy of the proxy voting advice that will be delivered to its clients. If the subject of the advice is not satisfied with the proxy adviser's finished product, it could force the adviser to include in the proxy advice (and on any electronic medium used to distribute the advice), a hyperlink directing the recipient of the advice to the subject's views on the advice. The adviser would effectively be barred from responding to the subject's statement, regardless of how objectionable, baseless or inaccurate it might be. These review, feedback and content-insertion benefits would be guaranteed to issuers of securities registered under Section 12 of the Exchange Act and certain other parties engaging in a solicitation, but not to shareholder proponents of ballot proposals.

The Commission also proposes to duplicate the substance of proxy advisers' existing conflict of interest disclosures, but with additional twists: Now advisers would have to disclose the new conflicts created by the unprecedented editorial rights the proposal would grant to the subjects of the proxy voting advice. In addition, the prescriptive requirements in the proposal for how disclosure is made do not align with the disclosure requirements in existing regulations.

The third aspect of the SEC's proposal is a litigation risk component. In this regard, the SEC seeks to build on the new liability theory it adopted in the Interpretation and Guidance with regard to Exchange Act Rule 14a-9, which prohibits material misstatements or omissions of fact in proxy solicitations. There, the Commission said that proxy advisers' "opinions, reasons, recommendations, or beliefs" can be "statements of material facts" actionable under 14a-9.[4] In a nod to those public companies who do not want to be judged by anything other than the lowest standards required by law, the Commission now proposes to force proxy advisers to make granular disclosure about how the voting guidelines their clients create or select differ from minimum market standards the SEC sets or approves.

ISS submits that there is no legal basis for any aspect of the proposal and that Congress never authorized the SEC to regulate either proxy advisers or proxy advice under the Exchange Act proxy rules. ISS further submits that the proposal to grant public companies and certain other solicitors the right to review, comment on and insert content into the advice proxy advisers render

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[3] *ISS v. SEC et al.,* 1:19-cv-03275 (D. D.C. filed 10/31/19). This case has been held in abeyance until the earlier of January 1, 2021 or the promulgation of final rules in this rulemaking.

[4] Interpretation and Guidance, *supra* note 2, at 11, 84 Fed. Reg. at 47419.

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to their clients is unconstitutional, since it infringes on advisers' First Amendment rights of free speech. By forcing proxy advisers to give their intellectual property to the subjects of their advice, the proposal also violates the Takings Clause of the Fifth Amendment of the Constitution and destroys ISS' reliance interests in maintaining the independence and integrity of its adviser-client relationships.

Furthermore, the proposal rests on the erroneous assertion that there are problems with the accuracy and integrity of proxy voting advice and ignores statements by the consumers of proxy advice that contradict that baseless assertion. The reality is that we at ISS go to great lengths to ensure the accuracy of the information that underpins our proxy research and recommendations and it is clear to us—after looking at the unsupported claims of "evidence" of pervasive errors—that most "errors" are actually differences over subjective interpretations or differing opinions on methodological frameworks.

The proposal is also unworkable. The suggested review, feedback and response-insertion provisions would severely impede proxy advisers' ability to deliver research and voting recommendations for U.S. corporations to investor clients in a timely fashion. We estimate that the review and feedback rights provided to registrants and certain other soliciting parties alone could reduce our report delivery time by between 45 and 65 percent, thus reducing the time available for shareholders to make the well-informed decisions that the proposals purport to encourage.

The proposal arbitrarily fails to explain why investors cannot be adequately protected under the fiduciary regime established under the Investment Advisers Act of 1940 (Advisers Act); nor does the proposal acknowledge, as it should have, that the suggested amendments to the proxy rules would duplicate, overlap and conflict with applicable Advisers Act rules.

The proposal's cost/benefit analysis is also seriously deficient. Among other things, it selects as a baseline the Interpretation and Guidance that the Commission adopted last August without undertaking any cost-benefit analysis, and without assessing the proposal's effect on competition. The proposal underestimates the operational costs of complying with the revised proxy rule exemptions and fails to calculate the costs to proxy advisers and their clients of managing and monitoring the new requirements resulting from the review, feedback and content-insertion provisions. The proposal also ignores the costs to proxy advisers of having to defend baseless lawsuits by disgruntled registrants under Rule 14a-9. With regard to impact on the capital markets, the proposal fails to recognize the likely diminution of competition and loss of diverse thought among proxy advisers, and the increased insider trading risks caused by proxy advisers' forced disclosure of material nonpublic information to registrants and certain other solicitors. On the other hand, the proposal's benefits, which are largely illusory, are grossly overstated.

The attached appendix examines these legal, factual, and economic deficiencies in detail. Because of these deficiencies, ISS strongly urges the Commission to withdraw this flawed proposal.

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We would be happy to supply the Commission or the staff with additional information regarding any of the matters discussed herein. Please direct questions about these comments to the undersigned, to our General Counsel, Steven Friedman, who can be reached at [redacted], or to our outside counsel, Mari-Anne Pisarri, who can be reached at [redacted].

Respectfully submitted,

Gary Retelny
President and CEO

cc: The Honorable Jay Clayton, Chairman
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison H. Lee
Dalia Blass, Director, Division of Investment Management
William Hinman, Director, Division of Corporation Finance
Rick Fleming, Office of the Investor Advocate

Comments on Proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, File No. S7-22-19

January 31, 2020

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* **Note on citations and terminology:** Unless otherwise indicated, references to the Securities Exchange Act of 1934 ("Exchange Act") mean 15 U.S.C. § 78a of the United States Code, where the Exchange Act is codified and references to Exchange Act Rules mean Title 17, Part 240 of the Code of Federal Regulations [17 CFR 240]. References to the Investment Advisers Act of 1940 ("Advisers Act") mean 15 U.S.C. § 80b, where the Advisers Act is codified, and references to Advisers Act rules mean Title 17, Part 275 of the Code of Federal Regulations [17 CFR 275].

As used in these comments, the term "adviser" refers to a fiduciary adviser, such as a proxy adviser or other registered investment adviser. "Advisor" is a broader term, encompassing both fiduciary advisers and non-discretionary financial professionals, including broker-dealers.

ISS submits that the Commission's proposal to amend certain Exchange Act proxy rules in order to regulate proxy advice as though it were a proxy solicitation[1]—like the "Interpretation and Guidance" on which this rulemaking is based[2] —is defective in many respects. ISS urges the Commission to withdraw this proposal in its entirety.

BACKGROUND

A. ISS' Proxy Voting Services

ISS is a full-service proxy adviser, whose services help institutional investors make informed proxy voting decisions, manage the complex process of voting their shares, and report their votes to their stakeholders and regulators. The company was founded in 1985, in an era of aggressive corporate practices such as raiding, greenmail and poison pills, when investors were seeking a meaningful voice in corporate governance. Today, ISS covers approximately 44,000 shareholder meetings a year in over 110 developed and emerging markets worldwide.

As part of its core offerings, ISS provides extensive corporate governance data and research as well as proxy voting recommendations. These voting recommendations are based on specific policy frameworks created or selected by institutional investors. ISS currently implements more than 400 custom voting policies on behalf of its clients. As of October 1, 2019, approximately 88% of ISS' top 100 clients used a custom proxy voting policy. Investors who choose not to create their own proxy voting policies may select among a range of policy options offered by ISS. These include benchmark policies focused on promoting long-term shareholder value creation, good governance and risk mitigation at public companies, and thematic policies that evaluate governance and voting issues from the perspective of sustainability, socially responsible investing, public funds, labor unions or mission and faith-based investing. By offering research and voting recommendations based on these different policies, ISS enables investors who may not have the need or resources to craft custom policies to tailor their proxy voting

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[1] *Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice,* Exchange Act Rel. No. 87457 (Nov. 5, 2019), 84 Fed. Reg. 66518 (Dec. 4, 2019), available at https://www.sec.gov/rules/proposed/2019/34-87457.pdf ("PA Proposal").

[2] *Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice,* Exchange Act Rel. No. 86721 (Aug. 21, 2019), 84 Fed. Reg. 47416 (Sept.10, 2019), available at https://www.sec.gov/rules/interp/2019/34-86721.pdf ("Interpretation and Guidance").

decisions to the specific investment objectives of their clients, thereby satisfying their fiduciary duty to act in their clients' best interests. Just as investors may have different investment time horizons, risk tolerances and investment strategies, so too, they may have different ways of assessing how proxy voting serves their investment goals. Although certain public companies seem to think otherwise, there is no "correct" way to vote a proxy; a shareholder's vote necessarily turns on that shareholder's particular goals and priorities.

ISS does not provide proxy voting advice to any shareholder who has not specifically engaged us for this purpose and selected the policy(ies) and services they require. Once engaged, we are obliged, by contract, to analyze and provide a voting recommendation for each agenda item related to every equity security held in the client's portfolio, and to do so in accordance with the policy or policies the client designates. ISS does not determine which issues appear on a proxy ballot, nor does it choose the ballots or agenda items on which it renders advice. It does not furnish research or make vote recommendations at the behest of any issuer or shareholder proponent of a ballot proposal. ISS is agnostic as to whether its clients support a proposal, reject a proposal or abstain from voting altogether. In sum, ISS' role is not to advocate for the passage or defeat of any particular ballot proposal but instead to help its clients make fully informed voting decisions in light of their chosen voting policies and their own goals and priorities.

Due to the diversity of policies and guidelines its clients employ, ISS may issue different recommendations to different clients on any given issue. For example, ISS may advise clients using its benchmark voting policy guidelines to vote "FOR" a certain proposal, while advising clients who employ faith-based or sustainability-based voting criteria to vote "AGAINST" that same proposal. ISS may also furnish divergent recommendations to investors on different sides of a proposed transaction such as a merger, with a "FOR" recommendation made to investors in one party to the merger, and an "AGAINST" recommendation made to investors in the other party, if ISS concludes that the former would benefit from the transaction, but the latter would not.[3]

In addition to supplying data, research and vote recommendations, ISS also provides an electronic platform that automates the operational aspects of proxy voting and allows institutional investors to focus their resources on the fiduciary task of making their voting decisions. In this regard, ISS' ProxyExchange platform enables investors to prepopulate their custom or other selected voting guidelines, flag issues of their choosing for manual review, override any particular vote recommendation and, notably, change any vote already cast, up to the issuer's vote cut-off deadline

[3] *See* U.S. Gov't. Accountability Office*, GAO-17-47, CORPORATE SHAREHOLDER MEETINGS, Proxy Advisory Firms' Role in Voting and Corporate Governance Practices, 27* (2016) ("2016 GAO Report").

(which, for U.S. issuers, is typically the day of the shareholder meeting). ProxyExchange also provides clients with issuer-specific information about potential conflicts of interest and does so in a way that protects the firewall ISS has established to mitigate such conflicts.[4] Moreover, ProxyExchange's sophisticated recordkeeping and reporting features facilitate an investor's testing of its own proxy voting decisions and practices and compliance with its vote disclosure obligations.

B. ISS' Regulatory Status

ISS has been registered with the SEC as an investment adviser since 1997. In this capacity, the company is subject to the extensive fiduciary regulatory regime established under the Advisers Act. This entails a range of requirements reasonably designed to ensure that ISS renders advice in its clients' best interests and that it does not place its own interests ahead of those of its clients. These requirements include (i) an obligation to maintain and regularly test a comprehensive compliance program, including policies and procedures relating to proxy voting, and policies and procedures designed to eliminate, or manage and disclose, conflicts of interest;[5] (ii) a duty to make full disclosure to clients of the methodologies it uses in rendering advice and any actual or potential conflicts of interest it might have;[6] and (iii) a duty to maintain a comprehensive set of books and records and to submit to the SEC's periodic examination of same.[7]

Where ISS renders advice to clients who are subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), ISS has a fiduciary obligation to discharge its duties solely in the interest of the ERISA plan's participants and their beneficiaries, and to act with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a like capacity would use in a similar situation.[8]

ISS is proud of the fiduciary bond it has forged with its investor clients over the years. Unfortunately, the current rule proposal would corrode that bond in several ways, as explained below.

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[4] See *infra* at 32.

[5] *See* Advisers Act Rules 206(4)-7 and 206(4)-6.

[6] Advisers Act Rules 203-1 and 204A-1 and Form ADV. *See infra* at 31-37 for more information on ISS' conflict of interest procedures and disclosures.

[7] Advisers Act Rule 204-2.

[8] ERISA § 404(a), 29 U.S.C. § 1104(a).

ANALYSIS

A. The Definitional Component; Proposed Changes to Rule 14a-1(*l*)

In the Interpretation and Guidance, the SEC redefined the term proxy "solicitation" under the Exchange Act proxy rules, without giving the public notice and an opportunity to comment. In so doing, the Commission, for the first time ever, decreed that the proxy voting advice that a professional adviser renders in the course of a fiduciary relationship with a shareholder is the type of "unsolicited" advice that constitutes a proxy solicitation. This novel reading of the Exchange Act was premised on the illogical assertion that because proxy advisers "[market] . . . their expertise in researching and analyzing proxy issues for purposes of helping clients make proxy voting determinations",[9] they should be regulated like parties who communicate with shareholders for the purpose of effectuating a particular outcome in a matter requiring a shareholder vote, consent or authorization. This is so, said the Commission, even where the fiduciary voting advice is based on "the client's own tailored voting guidelines."[10] In the current rule proposal, the Commission cites the Interpretation and Guidance (which ISS is currently challenging in court) [11] as an articulation of the existing state of the law.[12]

Perhaps recognizing that this expansive approach could capture any financial advisor who holds itself out as being willing and able to provide proxy voting advice to its clients,[13] the Commission proposes to codify a modified version of the definition of "solicitation" it adopted in the Interpretation and Guidance. The proposed definition would narrow the earlier definition so that it captures only a handful of firms—most notably, ISS and Glass, Lewis & Co., LLC ("Glass Lewis")—who have been the subject of a long-running campaign by certain issuers and their

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[9] Interpretation and Guidance, *supra* note 2, at 10, 84 Fed. Reg. at 47419.

[10] *Id.*, at 9, 84 Fed. Reg. at 47418.

[11] *ISS v. SEC et al.,* 1:19-cv-03275 (D. D.C. filed 10/31/19). This case is being held in abeyance until the earlier of January 1, 2021 or the promulgation of final rules in this rulemaking.

[12] PA Proposal, *supra* note 1 at 11 n. 21, 84 Fed. Reg. at 66520 n. 21 and accompanying text.

[13] For example, registered investment advisers who manage client portfolios frequently undertake to vote proxies on their clients' behalf. Those who do not offer this service may instead offer to make voting recommendations to clients so they can vote their own proxies. All registered investment advisers willing to provide these services must publicly say so, which could be construed as "marketing their expertise" in providing this type of investment advice. *See* Advisers Act, § 203(c), Rule 203-1 and Form ADV, Part 2A, Item 17. Full-service broker-dealers, although not fiduciaries, may also let clients know that they are willing and able to make proxy vote recommendations about securities held in clients' accounts. Where retail investors are involved, this service may be described in the broker's Form CRS, a public disclosure document that will be implemented in May 2020. *See* Exchange Act Rule 17a-14.

representatives to muzzle proxy advisers and hinder shareholders' ability to have a meaningful voice in corporate governance. In order to ring-fence this targeted subset of advisers, the Commission proposes to rebrand such firms—traditionally known as "proxy advisers" or "proxy advisory firms"—as "proxy voting advice businesses," a term that has never been used in law or commerce.

As proposed, the definitions of "solicit" and "solicitation" under Exchange Act Rule 14a-1(*l*) would be amended to include any

> *proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee.*[14]

For purposes of this definition, "proxy voting advice" would include proxy advisers' vote recommendations, along with the research and analysis they provide to enable their clients to evaluate the recommendations and make informed voting decisions. The term would not include advice furnished in response to an "unprompted" request, which seems to be a new twist on the Commission's historic concept of "unsolicited" advice, as discussed in more detail below.[15]

Although the SEC cites various provisions of the Exchange Act as the legal basis for its proposed amendment of Rule 14a-1(*l*),[16] none of the cited provisions authorizes the Commission to regulate proxy advice as a proxy solicitation. For example, while Section 3(b) generally authorizes the SEC to define terms, this power must be exercised "consistently with the provisions and purposes of this title." Likewise, Section 23(a) authorizes the agency to promulgate rules and regulations classifying persons, statements or reports, but only "as may be necessary or appropriate to implement the provisions of this title." The Commission's authority to define "solicit" or "solicitation" in this rulemaking, therefore, turns solely on the scope of the authority conferred by Section 14(a). This authority is nowhere near as broad as the Commission suggests.

1. Congress did not authorize the SEC to regulate proxy advice as a proxy solicitation.

A federal agency "literally has no power to act . . . unless and until Congress confers power upon it."[17] Here, Congress simply has not authorized the Commission to regulate proxy advice as

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[14] Proposed Rule 14a-1(*l*)(1)(iii)(A).

[15] Proposed Rule 14a-1(*l*)(2)(v). *See infra* at 12–13 and 29-30.

[16] PA Proposal at 129, 84 Fed. Reg. at 66555.

[17] *La. Pub. Svc. Comm'n v. FCC*, 476 U.S. 355, 374 (1986).

a proxy solicitation. Section 14(a) of the Exchange Act makes it unlawful to solicit or to permit the use of one's name to solicit a proxy, consent or authorization in contravention of the rules and regulations prescribed by the SEC. The statute does not define the term "solicit."

In an effort to demonstrate that Congress authorized the Commission to define "solicit" to mean "advise," the proposal disregards the statute's plain text, distorts the legislative history, mischaracterizes the case law, and offers a highly curated rendition of the SEC's own rulemaking in this area over the years.

We are pleased to address each of these topics.

a. The Plain Meaning of "Solicit"

In the absence of a statutory definition of the term "solicit," the word must be construed in light of its ordinary meaning at the time Section 14(a) was enacted.[18] Under a plain-text interpretation of the Exchange Act, a person who "solicits" a proxy is distinct from a person who "advises" about a proxy. At the time Congress enacted Section 14(a), "solicit" meant "[t]o ask for with earnestness, to make petition to, to endeavor to obtain, to awake or excite to action, to appeal to, or to invite"; and "solicitation" was defined as, "[a]sking; enticing; urgent request."[19] These definitions make clear that a solicitor necessarily has a certain *objective* or *goal* (*e.g.*, make a sale, win a vote, raise money for charity) and engages in solicitation (*e.g.*, appeals, requests, petitions, campaigns, etc.) in an attempt to *achieve* that objective. The phrase "solicit any proxy" thus has a clear and unambiguous meaning: to seek authority or ask a shareholder to vote a certain way in order to achieve a specific outcome in a matter requiring shareholder approval.

No reasonable user of the English language would confuse the concepts of "solicitation" and "advice." Whereas a solicitor urges another person to action to achieve a certain outcome or result, an adviser provides advice or counsel merely to help inform another person's decision. The contemporaneous definition of "advise" was "[t]o give an opinion or counsel, or recommend a plan or course of action. . . . 'Advise' imports that it is discretionary or optional with the person addressed

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[18] *Perrin v. United States,* 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning . . . at the time Congress enacted the statute ….").

[19] Black's Law Dictionary 1639 (3d ed. 1933); see also the Concise Oxford Dictionary of Current English 1150 (1931) (defining "solicit" as "[i]nvite, make appeals or requests to, importune"); Funk and Wagnalls New Standard Dictionary of the English Language 2315 (1932) (defining "solicit" as "[t]o ask for with some degree of earnestness; seek to obtain by persuasion or entreaty"). The proposal quotes an alternative definition of "solicit" in the Funk and Wagnalls Dictionary as "influence to action" [PA Proposal at 19 n. 48, 84 Fed. Reg. at 66523 n.48], but neglects to add the rest of this definition: "specif., to entice (one) to an unlawful act." ISS hopes that both sides of the corporate governance debate can agree that proxy voting is not such an act.

whether he will act on such advice or not."[20] The distinction between soliciting and advising is just as strong today as it was in the 1930s. Contemporary synonyms for "solicit" are "beg," "beseech," "implore" and "supplicate," while synonyms for "advise" include "caution," "point out" "recommend" and "suggest."[21]

The distinction between a person who solicits and one who advises is reflected in industry custom and usage as well. According to the 2016 GAO Report, a proxy solicitor is commonly understood to mean a "[s]pecialist (firm) hired to gather proxy votes," whose role is to "[h]elp public companies identify, locate, and communicate with shareholders to secure votes."[22] A proxy advisory firm, by contrast, is commonly understood to mean a "[t]hird-party that provides services to institutional investors that include research and vote recommendations on proposals."[23]

The Commission asserts that proxy advisers are engaged in solicitation because they "[market] . . . their expertise in researching and analyzing proxy issues for purposes of helping clients make proxy voting determinations."[24] But that theory is doubly flawed as a textual matter. First, the statutory text applies only to persons who "solicit any proxy." To the extent ISS markets its expertise to potential clients, ISS may be soliciting new clients and business, but it is not soliciting "any proxy." ISS' business marketing activities thus provide no basis for the Commission to assert jurisdiction over ISS under Section 14(a). Second, even assuming the Commission had some statutory authority to regulate proxy advisers based on their solicitation of new clients (which it does not), that still could not be used to justify aspects of this proposal, such as the issuer pre-review and response requirements. Those aspects have nothing to do with ISS' marketing of its expertise and everything to do with directly regulating (and interfering with) ISS' provision of fiduciary advice and recommendations to its clients. Thus, even under the Commission's own theory, there is a fundamental mismatch between the statutory authority it claims and the rules it has proposed.

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[20] *Black's Law Dictionary, supra* at 68 (internal citations omitted); *see also The Concise Oxford Dictionary of Current English* (1931) (defining "advise" as "[o]ffer counsel to" and "adviser" as a "person habitually consulted").

[21] *Roget's 21st Century Thesaurus* (3d ed. 2013), *available at* https://www.thesaurus.com/browse/solicit?s=t.

[22] 2016 GAO Report, *supra* note 3 at 6.

[23] *Id*.

[24] Interpretation and Guidance, *supra* note 2, at 10, 84 Fed. Reg. at 47419; *see also* PA Proposal at 16, 84 Fed. Reg. at 66522.

By the same token, the fact that proxy advisers, for a fee, provide vote recommendations and analysis to investors in advance of shareholder meetings does not make them proxy solicitors.[25] As noted above, a proxy adviser has no interest (financial or otherwise) in the outcome of any proxy vote and is indifferent to how its clients ultimately vote; indeed, a proxy adviser may offer different recommendations to different clients about the same vote depending on each investor's particular voting criteria and investing goals. These activities may be related to proxy votes, but they emphatically do not involve a "solicitation" under the ordinary meaning of that word.

The Commission's attempt to stretch the phrase "solicit any proxy" to cover independent, disinterested proxy voting advice contravenes not only the plain text the statute but also Congress' clearly-stated intent in enacting Section 14(a).

b. Legislative History

Selectively quoting words and phrases from congressional reports, the SEC contends that Congress gave the Commission the broad power to regulate *any* communication directed at shareholders concerning a matter as to which shareholder approval is required. ISS respectfully submits that looking at those words and phrases in context tells a much different story.

Congress enacted Section 14(a) in 1934 to eliminate the kinds of abuses that were deemed to have contributed to the stock market crash of 1929 and the Great Depression. Section 14(a) reflects the lawmakers' belief that, "A renewal of investors' confidence in the exchange markets can be effected only by a clearer recognition upon the part of the corporate managers of companies whose securities are publicly held of their responsibilities as trustees for their corporations."[26] Under the heading, "CONTROL OF UNFAIR PRACTICES BY CORPORATE INSIDERS," the House Committee on Interstate and Foreign Commerce said:

> Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies. Insiders having little or no substantial interest in the properties they manage have often retained their control without an ***adequate disclosure*** of their interest and without an adequate ***explanation*** of the management policies they intend to pursue. Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights. Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according to shareholders fair suffrage. For this reason the proposed bill gives the [Commission] ***power to control the conditions under which proxies may be solicited*** with a view to preventing

[25] *Id.* at 16, 84 Fed. Reg. at 66522.

[26] H.R. Rep. No. 73-1383, at 13 (1934).

> the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders.[27]

(Emphasis indicates the portions of this paragraph that are quoted in the proposal.)[28] The congressional record is replete with tales of such abuses, including instances in which proxies solicited ostensibly for a benign purpose were used for a nefarious purpose instead.[29]

The only parties other than corporate insiders who were on Congress' radar when it adopted Section 14(a) were outsiders who might misuse the proxy process to gain control over public companies:

> It is contemplated that the rules and regulations promulgated by the Commission will protect investors from promiscuous solicitation of their proxies, on the one hand, by irresponsible outsiders seeking to wrest control of a corporation away from honest and conscientious corporation officials; and, on the other hand, by unscrupulous corporate officials seeking to retain control of the management by concealing and distorting facts.[30]

There is not one shred of evidence in the congressional record to suggest that Congress authorized the SEC to use Section 14(a) to regulate persons who were not seeking to achieve a particular outcome in a proxy vote, such as independent, third-party advisers. Examining what the courts have said about this provision leads to the same conclusion.

c. Case Law

Over the years, the courts have confirmed that Congress designed Section 14(a) to cover persons who seek "to maintain or gain control of a corporation through solicitation of the corporate voting rights of the shareholders."[31] The courts have further recognized the purpose of this provision

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[27] *Id.* at 13-14.

[28] PA Proposal at 13 nn. 27 and 28, 84 Fed. Reg. at 66521 nn. 27 and 28.

[29] *See e.g.,* 78 Cong. Rec. 7923 (1934) (discussing abuses at American Tobacco; "His stockholders had no idea of what they were doing when they authorized proxies to vote to approve a plan which permitted [self-dealing by the president]. It is such things as that that this bill is designed to prevent."); S. Rep. No. 73-1455 at 74-75 (1934) (discussing abuses at American Commercial Alcohol Corporation). Although the PA Proposal quotes this Senate Report's statement about the importance of enlightening shareholders "as to the major questions of policy, which are decided at stockholders' meetings" [PA Proposal at 13 n. 27], the quotation omits the follow-on sentence, *viz.* "Too often proxies are solicited without explanation to the stockholder of the real nature of the matters for which authority to cast his vote is sought." S. Rep. No. 73-1455 at 74. An omitted discussion of the same corporate malfeasance precedes the proposal's quotation of another Senate Report for the proposition that "The committee recommends that the solicitation and issuance of proxies be left to regulation by the Commission." S. Rep. No. 73-792 at 12 (1934) *quoted in* PA Proposal at 13 n. 28, 84 Fed. Reg. 66521 n. 28.

[30] S. Rep. No. 73-1455 at 77.

[31] *Greater Iowa Corp. v. McLendon,* 378 F.2d 783, 795 (8th Cir. 1967).

is "to protect a shareholder's investment from self-serving designs of those at odds with the best interests of the corporation."[32] Although courts have adopted a broad reading of the term "solicitation" in a vertical sense—covering a chain of communications leading to a request for shareholder action by a party whose ultimate goal was to effect a particular outcome for the corporation[33]—courts have never stretched the concept horizontally to encompass parties who were completely indifferent to the outcome of the matter as to which shareholder approval was sought.

The Commission cites *Union Pacific R.R. Co. v. Chicago and North Western Ry. C*o.,[34] for the proposition that the proxy rules can lawfully be applied to financial advisers' reports, but reliance on this case is misplaced. The report at issue in *Union Pacific,* which favored the bid of one suitor over another in a contested merger, was written by an analyst employed by a broker-dealer that owned stock in the target company. The analyst prepared the report with the assistance of the favored suitor, and gave a draft of the report to that suitor for review and comment before its release. The report was mass-distributed to shareholders of the target company, including customers of the broker-dealer who issued the report and customers of other broker-dealers. The favored suitor and its proxy solicitors also distributed copies of the report, but did not file the report with the SEC. On these facts a Section 14(a) violation was alleged *not* against the broker, but against the suitor, who "candidly and repeatedly admitted in open court" that its use of the report violated the proxy rules.[35] Absolutely nothing about this case supports the proposal's treatment of independent proxy advice as a proxy solicitation under the Exchange Act.

In all cases where a proxy solicitation has been found, the "solicitor" had an identifiable interest in the outcome of the shareholder action.[36] This is so even where the communication in

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[32] *Cowin v. Bresler*, 741 F.2d 410, 427 (D.C. Cir. 1984). *See also Lynch v. Fulks*, 1980 U.S. Dist. LEXIS 16099 at *9 (D. Kan. 1980) ("The more fundamental purpose of [Section 14(a)] is to protect the investment of the corporate shareholder from those whose inclination to use the corporation for their own selfish ends conflict with the best interests of the corporation and its owners as a whole").

[33] *See Long Island Lighting Co. v. Barbash*, 779 F.2d 793 (2d Cir. 1985) (advertisement backed by parties interested in effecting changes at a public utility could be a solicitation if it constituted a step in a chain leading to a request to furnish, revoke or withhold proxies); *SEC v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943) (letter by shareholder asking fellow shareholders to withhold or revoke proxies so he could get himself elected as an officer of the company held to be a solicitation because it was "part of a continuous plan ending in solicitation and which [prepared] the way for its success").

[34] 226 F. Supp. 400 (E.D. Ill. 1964), cited in PA Proposal at 14 n. 31.

[35] 226 F. Supp. at 408.

[36] *See Bender v. Jordan*, 439 F. Supp. 2d 139 (D. D.C. 2006) (solicitation made by bank employee who sent a letter to shareholders to reject a dissident shareholder); *Canadian Javelin, Ltd. v. Brooks*, 462 F. Supp. 190, 194 (S.D.N.Y. 1978) (solicitation made by shareholders' committee formed to oust current management).

question was authored by a disinterested party.[37] While an issuer's deliberate misstatement of a proxy advisory firm's vote recommendation has formed the basis for a Section 14(a) claim against the company and its nominees for the board of directors,[38] no court has ever found a proxy adviser or other independent fiduciary itself to have "solicited" a proxy within the meaning of Section 14(a) and related rules.

In fact, no court has ever suggested that *any* party who advises one shareholder to vote for, and another shareholder to vote against, the same ballot proposal could be engaged in a solicitation. On the contrary, because solicitors communicate for the purpose of effecting a particular outcome, all the recommendations at issue in the Section 14(a) cases were unidirectional. Finally, no court has ever found that a shareholder was "solicited" by a communication he or she selected and paid to receive.

2. The SEC has historically acknowledged that applying the term "solicit" to disinterested persons who do not intend to ask shareholders to grant, revoke or withhold a proxy leads to a "distortion of the purposes of the proxy rules."

The SEC characterizes the proposal as a natural progression of the evolution of proxy regulation under the Exchange Act. ISS respectfully disagrees.

The Commission initially exercised its authority under Section 14(a) by adopting a narrow definition of "solicitation" that covered only a request to shareholders for a proxy, consent or authorization, or the furnishing of any form of proxy.[39] The Commission gradually expanded this definition to include a request for a proxy, whether or not such request was accompanied by or included in a form of proxy,[40] and a request not to execute or to revoke a proxy.[41] In 1956, the Commission adopted the current definition of "solicitation," which includes the furnishing of any "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.[42]

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[37] *See Crouch v. Prior,* 905 F. Supp. 248 (D. V.I. 1995) (research analyst note imputed to member of the board of directors seeking shareholder consent to change the composition of the board; author of the note not alleged to have solicited a proxy or to have permitted the use of her name for that purpose).

[38] *Burkle v. OTK Assocs., LLC*, 2 F. Supp. 3d 519 (S.D.N.Y. 2014).

[39] Exchange Act Rel. No. 378 (Sep. 24, 1935), 1935 SEC LEXIS 1877.

[40] Exchange Act Rel. No. 1823 (Aug. 11, 1938), 3 Fed. Reg. 1991-92 (Aug. 13, 1938).

[41] *Solicitation of Proxies Under the Act,* Exchange Act Rel. No. 3347 (Dec. 18, 1942), 7 Fed. Reg. 10653, 10656 (Dec. 22, 1942).

[42] *Adoption of Amendments to Proxy Rules,* Exchange Act Rel. No. 5276 (Jan. 17, 1956), 21 Fed. Reg. 577 (Jan. 26, 1956) ("1956 Release"). This definition is now found in Exchange Act Rule 14a-1(*l*).

Although the proposal suggests that the 1956 amendment did away with the notion that a person who solicits a proxy must have some interest in the outcome of the action requiring shareholder approval,[43] that is not so. When it adopted this amendment, the Commission made it clear that it was expanding the *range of communications* covered by the definition, but not the *class of people* considered to be solicitors. In this regard, the Commission explained that

> statements made for the purpose of inducing security holders to give, revoke, or withhold a proxy with respect to a matter to be acted upon by security holders of an issuer, including an election of directors, *by any person who has solicited or intends to solicit proxies*, whether or not such statements are accompanied by an express request to give, revoke, or withhold a proxy may involve a solicitation within the meaning of the regulation, depending upon the particular facts and circumstances.[44]

The use of the word "procurement" in the 1956 definition confirms that a party who "solicits" has an interest in the outcome of the vote, because "procure" means "to get possession of," "obtain by particular care and effort," "to bring about" or "achieve."[45] Although a literal reading of the 1956 amendment thus comports with Congress' intent that a "solicitation" involves a concerted effort to achieve a desired result, the SEC eventually realized that the amendment could also be misread "potentially to turn almost every expression of opinion concerning a publicly-traded corporation into a regulated proxy solicitation", which would distort the purpose of Section 14(a).[46] The path to this realization was as follows:

In 1964, the Commission released an opinion addressing whether the participation of broker-dealers in the proxy process could constitute a solicitation under the 1956 definition.[47] This opinion stated that the proxy rules might, under appropriate circumstances, apply to any person, not just management or the opposition engaged in a struggle for corporate control. Noting that broker-dealers are "particularly likely to become involved in proxy solicitations both because they may have an interest in the matters to be voted on and because they may have connections with management, opposition, or other participants", the opinion suggested that a broker-dealer who

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[43] PA Proposal at 14-15, 84 Fed. Reg. at 66521.

[44] 1956 Release, 21 Fed. Reg. at 577 (emphasis supplied).

[45] *Webster's Ninth New Collegiate Dictionary* 938 (1987); *see also Black's Law Dictionary* 1372 (4th ed. 1951) (defining "procuration" as "[t]he act by which one person gives power to another to act in his place, as he could do himself").

[46] *Regulation of Communications Among Shareholders,* Exchange Act Rel. No. 31326 (Oct. 16, 1992) 57 Fed. Reg. at 48276, 48278 (Oct. 22, 1992) ("1992 Release").

[47] *Broker-Dealer Participation in Proxy Solicitations*, Exchange Act Rel. No. 7208 (Jan. 7, 1964), 29 Fed. Reg. 341 (Jan. 15, 1964) ("1964 Release").

“goes beyond [his] advisory function” and “voluntarily” distributes solicitation-type material ”to persons who have not asked for it”—which the SEC called “unsolicited” advice—could be subject to the proxy rules.[48] On the other hand, the rules would not apply to a broker-dealer who merely gave proxy voting advice “in his capacity as adviser to the customer.”[49]

Recognizing that it would be inconsistent with the purpose of Section 14(a) to subject all financial professionals who furnish unsolicited proxy advice to the full panoply of the proxy rules, the Commission in 1979 exempted certain financial advisors from the information and filing requirements of the proxy rules under specified conditions.[50] The purpose of this exemption, which today resides in Exchange Act Rule 14a-2(b)(3), was "to provide greater opportunities for shareholders to exercise their right of suffrage and to obtain information and advice with respect to matters on which they vote."[51]

In adopting this exemption, the Commission confirmed that not all persons who furnish proxy voting advice need relief from the proxy rules, because the rules apply only to "those who participate in the solicitation of proxies."[52] Under ordinary circumstances, this population excludes those who render advice in the course of a fiduciary relationship with an investor, such as attorneys or accountants. Furthermore, by titling its discussion of the exemption "Unsolicited Voting Advice Furnished by Financial Advisors,"[53] the SEC confirmed that the exemption was designed for those who "voluntarily" distribute soliciting material "to persons who have not asked for it," because those who in act in their "capacity as adviser to the customer" are not proxy solicitors in the first place.[54]

In 1992, recognizing that its reading of the solicitation definition was still too broad, the Commission adopted another package of reforms designed to remove "unnecessary government interference in discussions among shareholders" and to make it easier for shareholders to challenge

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[48] *Id.*

[49] *Id.*

[50] Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Rel. No. 16356 (Nov. 21, 1979), 44 Fed. Reg. 68764 (Nov. 29, 1979) ("1979 Release").

[51] 1979 Release, 44 Fed. Reg. at 68764.

[52] *Id.* at 68767 n. 11.

[53] *Id.* at 68766.

[54] 1964 Release, *supra* note 47.

management through the proxy voting process.[55] The Commission took this action with the support of the shareholder community and over the objections of the corporate community.

In undertaking these reforms, the Commission traced the history of its definition of "solicitation," starting with a recognition of the agency's mandate "'to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitations.'"[56] The Commission singled out the 1956 amendment of the solicitation definition as the point at which the proxy rules began to have unintended consequences:

> In adopting the sweeping 1956 definition, the Commission sought to address abuses by persons who were actually engaging in solicitations of proxy authority in connection with election contests.[fn] The Commission does not seem to have been aware, or to have intended, that the new definition might also sweep within all the regulatory requirements persons who did not 'request' a shareholder to grant or to revoke or deny a proxy, but whose expressed opinions might be found to have been reasonably calculated to affect the views of other shareholders positively or negatively toward a particular company and its management or directors.[57]

The SEC candidly acknowledged the "excessive regulatory reach" of this construction of the term "solicitation" and admitted that this construction led to a "distortion of the purposes of the proxy rules."[58] However, instead of amending the definition to make sure it aligned with Congress's intent, the Commission simply adopted another limited exemption from the information and filing requirements of the proxy rules. This exemption covers a person who does not seek proxy authority and who does not have a substantial interest in the matter subject to shareholder action, other than a general interest as a shareholder (including a shareholder proponent of a ballot proposal), and, in some cases, an employee of the registrant.[59]

Recognizing that the parties for whom the exemption was designed may not be engaged in proxy solicitations at all, the Commission confirmed that the existence of the exemption was not meant to broaden the pool of communications subject to the proxy rules. Instead, the Commission explained, the exemption was intended to protect a person who does not seek proxy authority and

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[55] 1992 Release, *supra* note 46, 57 Fed. Reg. at 48276.

[56] *Id*. 57 Fed. Reg. at 48277, *quoting J.I. Case v. Borak*, 377 U.S. 426, 431 (1964).

[57] *Id.* 57 Fed. Reg. at 48277-78. The internal citation in this passage explains that in 1956, "the Commission was principally concerned with communications 'by any person who has solicited or intends to solicit proxies' prior to the formal commencement of the solicitation." *Id.* at 48277 n. 22. In other words, this was intended to be a vertical expansion of the concept of "solicitation," not a horizontal one.

[58] *Id*. 57 Fed. Reg. at 48278.

[59] Rule 14a-2(b)(1).

who does not have a substantial interest in the matter subject to shareholder action from the vagaries of an imprecise and overly broad definition that exposed them to the risk of baseless litigation for criticizing the quality of a company's management, thereby chilling discussion of management performance, in contravention of Congress's intent.[60]

It was not until the SEC adopted the Interpretation and Guidance in August 2019, that the proxy rules were ever deemed to apply to a financial advisor who did not go beyond its advisory function and distribute solicitation-type material to shareholders who did not ask for it.[61] Nor, until then, had the SEC ever said that the proxy rules apply to advice rendered by a disinterested party in the context of a fiduciary relationship. Therefore, the Interpretation and Guidance was not part of the natural evolution of proxy regulation but was a jarring break with the past instead.

The SEC cites four factors to justify its determination that independent proxy advice is a proxy solicitation for purposes of Section 14(a): (i) proxy advisers typically provide a vote recommendation for specific proposals that will be presented at a shareholder meeting; (ii) proxy advisers market their expertise in researching and analyzing shareholder ballot proposals in order to help investors make informed voting decisions; (iii) institutional investors engage proxy advisers to render expert proxy advice for a fee; and (iv) proxy advisers make vote recommendations to shareholders shortly before a shareholder meeting or authorization vote.[62] None of these factors, alone or in combination, has any grounding in the statutory text or any bearing whatsoever on the proper application of the proxy rules. In fact, they highlight just how inapposite these rules are to proxy advisers.

"Unscrupulous corporate officials" and "irresponsible outsiders seeking to wrest control of a corporation" from honest management[63] do not market their expertise in researching and analyzing shareholder ballot proposals. Parties who seek to use the proxy process to "maintain or gain control" of a company[64] do not provide vote recommendations for every ballot proposal relating to

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[60] 1992 Release, 57 Fed. Reg. at 48279.

[61] The proposal cites the *Concept Release on the U.S. Proxy System*, Exchange Act Rel. No. 62495 (July 14, 2010), 75 Fed. Reg. 42982 (July 22, 2010) ("Concept Release") as an earlier articulation of the possibility that the proxy rules could apply to proxy advisers. PA Proposal, *supra* note 1 at 15 n. 37. However, the brief discussion of the proxy rules in the Concept Release was premised on the 1964 Release, which indicates that the discussion was limited to proxy advice that is voluntarily distributed to shareholders who have not asked for it. Concept Release at 108, 75 Fed. Reg. at 43009 and n. 244.

[62] PA Proposal at 16, 84 Fed. Reg. at 66522.

[63] S. Rep. No. 73-1455 *supra* note 29 at 77.

[64] *Greater Iowa Corp. v. McLendon, supra* note 31, 378 F.2d at 795.

an investor's entire securities portfolio, and certainly do not provide different vote recommendations to different investors based on each investor's chosen voting criteria. And institutional investors do not engage such self-interested parties to render expert proxy advice for a fee. No matter which path you take—legislative, judicial or administrative—the conclusion is the same: Congress did not authorize the SEC to regulate proxy advisers or proxy advice under Section 14(a).

That does not mean, however, that proxy advice is free from SEC oversight. On the contrary, Congress provided a specific way to regulate those who perform this important function.

3. Proxy advisers are properly regulated under the Advisers Act.

The last in the series of post-Depression-era statutes governing the U.S. financial markets, the Advisers Act addressed concerns about the nascent investment counsel industry. The increased complexity of the securities markets following World War I and concomitant rise in demand for professional advisory services led to the development and explosive growth of this new industry.[65] Congress designed the Advisers Act to eliminate "tipster" services who masqueraded as bona fide investment counsellors rendering competent and impartial investment advice.[66]

In particular, the Advisers Act established a federal fiduciary standard of conduct for investment advisers based on equitable common law principles.[67] This fiduciary standard is comprised of duties of care and loyalty, which, taken together, oblige an adviser to act in the best interests of its clients and not to place its own interests ahead of its clients' interests.

The first step in analyzing whether proxy advisers are subject to regulation under the Advisers Act is to determine whether such firms fit the general statutory definition of "investment adviser." If the answer is yes, the second step is to determine if proxy advisers qualify for a statutory exception to the investment adviser definition. If that answer is no, the final step is to determine whether such advisers are properly regulated by the SEC or the states.

a. General Definition of Investment Adviser

Section 202(a)(11) of the Advisers Act defines the term "investment adviser" to mean "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues

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[65] SEC, "Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services," H.R. Doc. No. 76-477 at 1, 23 (1939).

[66] *Id.* at 28.

[67] *Transamerica Mortg. Advisors, Inc. v. Lewis,* 444 U.S. 11, 17 (1979); *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 194 (1963) ("Capital Gains").

or promulgates analyses or reports concerning securities." This broad definition encompasses not only those who manage client portfolios, but anyone who is paid to provide advice about securities, unless an exception applies.

A proxy vote appurtenant to shares held in a portfolio is itself an asset to be managed with the same care and skill as any other portfolio asset.[68] The SEC has long recognized that through their proxy voting authority, investment managers are in a position "to significantly affect the future of corporations and, as a result, the future value of corporate securities held by their clients."[69] Proxy advisers render advice *as to the value of securities* when they advise their clients on ballot measures that could affect share prices, such as mergers and acquisitions and director elections, particularly in contested director elections. In addition, when proxy advisers opine on ballot items such as mergers or acquisitions, they may render advice as to the *advisability of purchasing* (for the acquiring company) *or selling* (for the company being acquired) *securities*.

Proxy advisers also issue research reports about companies, their boards and management and their securities, so that their investor clients can understand and assess the vote recommendations. In so doing, proxy advisers *issue or promulgate analyses or reports concerning securities.* The SEC has recognized that in addition to assisting in the making of proxy voting determinations, these reports and analyses may also assist in the making of investment decisions, which is a core function of investment advisers.[70]

Although performing any one of the functions described in Section 202(a)(11) is enough to characterize a party as an investment adviser, proxy advisers perform all three. Because they do so for compensation and as part of a regular business, there is no doubt that proxy advisory firms fit the general definition of "investment adviser" for purposes of the Advisers Act. The Commission reached the same conclusion in the 2010 Concept Release, when it said:

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[68] Letter from Alan D. Lebowitz, Deputy Assistant Secretary, U.S. Dept. of Labor to Mr. Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. (February 23, 1988), 1988 ERISA LEXIS 19, *5-6, *codified* in 29 C.F.R 2509.2016-01 ("The fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock").

[69] *Proxy Voting by Investment Advisers,* Advisers Act Rel. No. IA-2106 (Jan. 31, 2003) at 2, 68 Fed. Reg. 6585, 6586 (Feb. 7, 2003) ("Advisers Act Proxy Rule Release"). *See also Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, Investment Company Act Rel. No. 25922, 68 Fed. Reg. 6564, 6566 (Feb. 7, 2003) ("Proxy voting decisions by funds can play an important role in maximizing the value of the funds' investments").

[70] *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934,* Exchange Act Rel. No. 54165 (July 18, 2006) at 37, 71 Fed. Reg. 41978, 41988 (July 24, 2006).

[P]roxy advisory firms receive compensation for providing voting recommendations and analysis on matters submitted for a vote at shareholder meetings. . . . We understand that typically proxy advisory firms represent that they provide their clients with advice designed to enable institutional clients to maximize the value of their investments. In other words, proxy advisory firms provide analyses of shareholder proposals, director candidacies or corporate actions and provide advice concerning particular votes in a manner that is intended to assist their institutional clients in achieving their investment goals with respect to the voting securities they hold. In that way, proxy advisory firms meet the definition of investment adviser because they, for compensation, engage in the business of issuing reports or analyses concerning securities and providing advice to others as to the value of securities.[71]

b. Exceptions to the Definition of Investment Adviser

Over the years, it has been suggested that proxy advisers might qualify for a statutory exception to the investment adviser definition, thereby relieving them of the need to register under the Advisers Act. The exception most often cited—for "the publisher of any *bona fide* newspaper, news magazine or business or financial publication of general and regular circulation"[72]—does not apply.

The Supreme Court has interpreted the "publisher's" exception to require, among other things, that the publication render *impersonal* advice, as opposed to advice tailored to the specific needs or objectives of the subscriber.[73] In applying this interpretation the SEC staff has taken the view that interactive communication between the provider and recipient of investment advice is not "impersonal" and that interactivity destroys the availability of the publisher's exception.[74]

Judged by this standard, proxy advisers are clearly not publishers. As part of their suite of services, proxy advisory firms help institutions adopt and implement proxy voting policies that best serve the needs of their underlying investor clients.[75] Furthermore, in addition to issuing research reports and vote recommendations based on the different, proprietary proxy voting guidelines that can be selected by their clients, proxy advisers provide many clients with

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[71] Concept Release, *supra* note 61 at 109-110, 75 Fed. Reg. at 43010.

[72] Advisers Act, § 202(a)(11)(D).

[73] *Lowe v. SEC*, 472 U.S. 181 (1985).

[74] *See* Reuters Information Services, Inc. 1991 SEC No-Act. LEXIS 96 (Jan. 17, 1991).

[75] *See, e.g., Egan-Jones Proxy Services*, https://www.ejproxy.com/services/ (last visited Jan.22, 2020) ("Egan-Jones reviews the client's research and voting requirements including voting guidelines. If desired, Egan-Jones suggests modification to the client's proxy voting guidelines to facilitate fulfillment of fiduciary obligations.")

individually customized vote recommendations based on a client's specific (or custom) voting guidelines.[76] Not only are custom vote recommendations "personalized" by their very nature, but they also entail a high degree of interactive discussion between proxy advisers and their investor clients. Moreover, because a custom vote recommendation is provided only to the client who owns the policy on which the recommendation is based, it is abundantly clear that such recommendations fail to satisfy the publisher's exception requirement that advice be of "general and regular circulation."[77]

c. Qualifying for Registration with the Commission

By virtue of the National Securities Markets Improvement Act of 1996 ("NSMIA"),[78] an investment adviser is precluded from registering with the SEC, and is subject instead to state jurisdiction, unless that adviser qualifies for federal registration under Section 203A of the Advisers Act or Rule 203A-2 thereunder. Today, three of the five U.S. proxy advisers, including ISS, are registered as investment advisers with the SEC in reliance on the category for pension consultants found in Rule 203A-2(a).[79] While the other two proxy advisers are not registered at either the federal or state level, at least one, and possibly both, of these firms also qualify for SEC registration under this NSMIA category.[80]

This three-part analysis leaves no room for doubt that the proper regulatory regime for proxy advisory firms is the one Congress created in the Advisers Act.

4. The proposal's perfunctory treatment of the Advisers Act is inconsistent with existing law, rules and prior Commission statements, and is antithetical to the professed objectives of this rulemaking.

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[76] *See* 2016 GAO Report, *supra* n. 3; Transcript of the Roundtable on the Proxy Process at 193 (Nov. 15, 2018) *available at* https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf, ("2018 Roundtable Transcript").

[77] The definitional exception for Nationally Recognized Statistical Rating Organizations (NRSROs), found in Advisers Act § 202(a)(11)(F) is also unavailable to proxy advisers. This exception, adopted in 2006, was designed to relieve credit rating agencies who opt to register under a voluntary regulatory regime found in Section 15E of the Exchange Act from the need also to register as investment advisers under the Advisers Act. By its terms, the exception is limited to credit rating activities. An NRSRO that also makes recommendations as to purchasing or selling securities—such as a proxy adviser—cannot avail itself of the NRSRO exception.

[78] Pub. L. No. 104-290, 110 Stat. 3416 (1996).

[79] PA Proposal, *supra* note 1 at 86, 88-89, 84 Fed. Reg. at 66543.

[80] *Id.* at 10 n. 18, 84 Fed. Reg. 66520 n. 18. Note that § 203A(c) of the Advisers Act authorizes the Commission to exempt advisers from the prohibition on registration if the prohibition would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of NSMIA. This provides another avenue for SEC registration.

While the proposal acknowledges that the Commission already regulates a majority of U.S. proxy advisers as investment advisers,[81] the proposal is devoid of any substantive discussion of the applicability of the Advisers Act regulatory regime to proxy advisory firms. Nor is there any discussion of the ability of this regime to address the concerns that purportedly underlie this rulemaking. The Commission's silence here is inexplicable, given the agency's previous determination that proxy advisers meet the statutory definition of "investment adviser," and given the proposal's focus on investor protection.[82]

The proposal dismisses the relevance of the Advisers Act to the question of whether the proxy rules serve as a legitimate basis for regulating proxy advisers by noting that "it is not unusual for a registrant under one provision of the securities laws to be subject to other provisions of the securities laws when engaging in conduct that falls within the other provisions."[83] ISS does not find this observation applicable to the question at hand. While different activities may be governed by different provisions of the securities laws, the SEC does not regulate a single activity twice.[84] In fact, the Advisers Act has been designed expressly to avoid such regulatory overlap.

In this regard, the statute provides exceptions to the definition of "investment adviser" and an exemption from the registration requirements for parties whose advisory activities are already governed by, or are incidental to financial services governed by, another regulatory regime.[85] Furthermore, in adopting NSMIA, Congress divided jurisdiction over investment advisers between the SEC and the states for the express purpose of eliminating duplicative regulation.[86] And the SEC itself has taken steps to mitigate duplication with regard to investment advisers who are also registered as broker-dealers.[87]

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[81] *Supra* note 79.

[82] PA Proposal at 27, 84 Fed. Reg. at 66525.

[83] *Id.* at 18 n. 47, 84 Fed. Reg. at 66522 n.47.

[84] For example, a firm that both effects securities transactions and provides more than incidental investment advice may be governed by the Exchange Act for its brokerage business and the Advisers Act for its advisory business, but neither statute broadly regulates both activities.

[85] The Advisers Act provides such definitional exceptions to banks (Section 202(a)(11)(A)); broker-dealers (Section 202(a)(11)(C)); and registered credit rating agencies (Section 202(a)(11)(F)). A registration exemption is provided to certain advisers who are registered as commodity trading advisers with the Commodity Futures Trading Commission. Section 203(b)(6).

[86] *See supra* note 78.

[87] *See e.g.* Advisers Act Rule 204-2(h).

Respecting the boundaries between different provisions of the securities laws is not the exclusive province of the Advisers Act. In 1992, the SEC rejected calls by the issuer community to regulate certain shareholder communications under the proxy rules because Congress provided another Exchange Act provision for that purpose:

> *When and under what circumstances a large shareholder, or group of shareholders acting together, must reveal to the SEC, the company, other shareholders, and the market its plans and proposals regarding the company has been addressed by Congress, but not through the provisions governing proxy solicitations. Section 13(d) of the Exchange Act, as implemented by the Commission in its regulations adopted thereunder, sets forth the circumstances when public disclosure of plans and proposals by significant shareholders, as well as agreements among shareholders to act together with respect to voting matters, must be disclosed to the market.*[88]

By parity of reasoning, it is inappropriate to regulate the advice rendered by proxy advisers under Section 14(a) of the Exchange Act because Congress provided the Advisers Act for that purpose.

- **How the Advisers Act Addresses the Professed Objectives of this Rulemaking**

In proposing this package of rule amendments, the Commission emphasizes its interest in protecting investors and says that "concerns" have been expressed about the "accuracy and soundness" of proxy advisers' vote recommendations, as well as conflicts of interest that could potentially affect those recommendations.[89] Given this motivation, the short shrift the proposal gives to the Advisers Act is puzzling, because these are precisely the types of issues this regulatory regime was designed to address.

As previously explained, the Advisers Act establishes a federal fiduciary standard of conduct that imposes duties of care and loyalty on investment advisers; obliges advisers to act in the best interests of their clients; and forbids advisers to place their own interests ahead of the interests of their clients.[90] The Commission has previously acknowledged the applicability of this standard to proxy advisers, saying that "[a]s investment advisers, proxy advisory firms owe fiduciary duties to their advisory clients."[91]

In the 2019 Fiduciary Standard Release, the Commission confirmed that the fiduciary duty of care obliges an adviser to reasonably ensure the accuracy and soundness of the advice it

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[88] 1992 Release, *supra* note 46, 57 Fed. Reg. at 48278 (internal citation omitted).

[89] PA Proposal at 10-11, 84 Fed. Reg. at 66520.

[90] *See supra* at 16.

[91] Concept Release, *supra* note 59 at 110, 75 Fed. Reg. at 43010.

renders. In this regard, the Commission cited the Concept Release, which said,

> [*A]s a fiduciary, the proxy advisory firm has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information.*[92]

The Commission further explained that the duty of loyalty requires an adviser to "eliminate or at least expose through full and fair disclosure all conflicts of interest which might incline [the] investment adviser – consciously or unconsciously -- to render advice [that is] not disinterested."[93]

In order to enforce these duties, the Advisers Act regulatory regime imposes a host of specific obligations on advisers. These include a requirement to implement and maintain a comprehensive compliance program and to test the sufficiency and effectiveness of that program at least annually;[94] a requirement to implement procedures to prevent the misuse of material nonpublic information as well as a written code of ethics;[95] and a requirement to disclose both the methods of analysis and policies and procedures used in formulating proxy voting advice, along with meaningful information about conflicts of interest and their mitigation.[96]

The Advisers Act further prohibits advisers from engaging in fraudulent or deceptive conduct.[97] This antifraud provision and the SEC's rules thereunder apply to any person who falls within the definition of investment adviser, whether that person is required to register under the statute or not.[98]

Registered investment advisers also have extensive recordkeeping requirements,[99] and they must make those records available for inspection by the SEC's Office of Compliance Inspections and Examinations (OCIE). In 2015, this office designated proxy advisers as a priority

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[92] *Id.* at 119, 75 Fed. Reg. at 43012 cited in *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Rel. No. 5248 (June 5, 2019) at 16 and n. 40, 84 Fed. Reg. 33669, 33674 and n. 40 (July 12, 2019) ("Fiduciary Standard Release").

[93] *Id.* at 23, 84 Fed. Reg. at 33676, *citing Capital Gains, supra* note 67, 375 U.S. at 191.

[94] Rule 206(4)-7.

[95] Section 204A and Rule 204A-1.

[96] Rule 203-1; Form ADV.

[97] Section 206.

[98] Concept Release *supra* note 61 at 110, 75 Fed. Reg. at 43010; *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services,* Advisers Act Rel. No. 1092 (Oct. 8, 1987), 52 Fed. Reg. 38400 (Oct. 16, 1987).

[99] Rule 204-2.

in its National Examination Program. Among the issues OCIE identified for inspection were how proxy advisers make recommendations on proxy voting and how they disclose and mitigate potential conflicts of interest.[100]

Other than noting that proxy advisers "that are investment advisers are already required to identify conflicts and to eliminate or make full and fair disclosure of those conflicts,"[101] the proposal ignores the relevance of the Advisers Act regime and makes no attempt to explain why this framework is inadequate to address the Commission's purported concerns about proxy advice. ISS respectfully submits that this silence does a disservice to investors, who deserve sound, accurate and independent proxy voting advice from appropriately regulated sources. It also undercuts the purported justification for this regulatory undertaking, as do questions about the integrity of the public record on this issue to date.

5. In seeking to justify the proposed rule amendments, the Commission seems to have ignored the findings of its own Roundtable and relied on fraudulent public comments.

In the 2018 Roundtable on the Proxy Process, the Commission convened a special panel to address issues relating to proxy advisers. Participating in this panel were institutional investors who use proxy advisory services, public company representatives, proxy advisers themselves, a law professor and a former U.S. Senator. A few striking aspects of this session of the roundtable merit attention.

First, there was no discussion whatsoever of whether proxy *advice* constitutes a proxy *solicitation* or whether a proxy *adviser* should be regulated as a proxy *solicitor*. The issue never came up, just as it never came up at the roundtable on proxy adviser issues the SEC hosted in 2013.[102] Second, as discussed more fully below, none of the investors on the panel expressed the conflict-of-interest and accuracy concerns the Commission cites to justify the proposed rule amendments. Finally, and relatedly, not one single participant at this session saw a need to impose

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[100] SEC, OCIE, National Exam Program, *Examination Priorities for 2015 at 4*, available at https://www.sec.gov/ about/offices/ocie/national-examination-program-priorities-2015.pdf.

[101] PA Proposal at 105, 84 Fed. Reg. at 66548.

[102] Transcript of the Roundtable on Proxy Advisory Services (Dec. 5, 2013) *available at* www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt ("2013 Roundtable Transcript").

additional regulation on proxy advisers, a fact that seemed to surprise the SEC staff moderating the panel.[103]

Lacking any support for change from the panel it convened to examine proxy adviser issues, the Commission turns instead to some written comments it received in connection with the roundtable. Here, the most vocal advocates for new regulation were public companies and their well-financed representatives.[104] Given that Congress enacted 14(a) of the Exchange Act to control unfair practices by corporate insiders, these parties are odd spokespersons indeed for the shareholder community. The Commission also relies on comments it received from groups calling themselves "Main Street Investors Coalition" and "60 Plus Association" and a handful of individuals claiming to be retail investors with grave concerns about proxy advisers.

The provenance of these investor comments was called into question in a November 19, 2019 Bloomberg article.[105] According to this article, the "Main Street Investors Coalition" was formed in part and funded in large measure by the National Association of Manufacturers, while the 60 Plus Association, a member of the Main Street Investors Coalition, "routinely takes money from corporations and advocates for their causes."[106] The legitimacy of the individual investor letters cited in the proposal is also in doubt. Most or all of these letters reportedly were orchestrated by these disguised corporate advocates, and some investors have disavowed any knowledge of letters submitted in their names.[107]

The problem of "astroturf" comments was the subject of a recent U.S. Senate Staff report.[108] Noting that it "is a federal crime to 'knowingly and willfully' make 'any materially false,

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[103] Remarks of Michelle Anderson, Moderator, 2018 Roundtable Transcript, *supra* note 76 at 250 ("I can't believe [it]. Is there anyone on the panel that thinks there should be additional regulation? I haven't heard it yet, and I'm kind of surprised").

[104] PA Proposal at 11 n. 24 and 26 n. 70. These include the Society for Corporate Governance, Center on Executive Compensation, Wachtell Lipton, Rosen & Katz, the National Association of Manufacturers, the Business Roundtable, the National Investor Relations Institute, the U.S. Chamber of Commerce and Exxon Mobil Corporation.

[105] Zachary R. Mider & Benjamin Elgin, SEC Chairman Cites Fishy Letters in Support of Policy Change, Bloomberg (Nov. 19, 2019).

[106] *Id.*

[107] *Id.*

[108] Staff of S. Perm. Subcomm. On Investigations, Comm. On Homeland Sec. and Gov'tal. Affairs, 116th Cong., Rep. on, *Abuses of the Federal Notice-and-Comment Rulemaking Process* (Subcomm. Print 2019) The report defines "astroturfing" as "organized activity that is intended to create a false impression of a widespread, spontaneously arising, grassroots movement in support of or in opposition to something . . .

fictitious, or fraudulent statement or representation' to the federal government,"[109] the report recommends that federal agencies refer allegations of fraudulent comments to the appropriate law enforcement agencies, and that they not make such comments available for public viewing.[110]

ISS believes that the cynical misuse of the public comment process in the instant matter should not go unaddressed. We urge the Commission to undertake a thorough investigation into the allegations made in the Bloomberg article and take whatever steps are necessary to safeguard the integrity of the agency's rulemaking.

If the Commission is looking for honest input on the best way to protect retail investors, it need look no further than its own Office of the Investor Advocate ("OIA"). Created in 2014 under Section 915 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the OIA is charged with identifying areas in which investors would benefit from changes in the regulations of the Commission; identifying problems that investors have with financial service providers and investment products; analyzing the effects of rulemaking on investors; and, where practicable, proposing to the Commission any legislative, administrative, or personnel changes that may be appropriate to promote the interests of investors.[111]

In its "Report on Objectives" for Fiscal Year 2020,[112] the OIA confirmed that it is "very focused" on issues related to proxy voting. While it recognized a general consensus regarding reforms in areas such as accurate vote counts, vote reconciliations and vote confirmations—popularly known as "proxy plumbing" issues—the OIA was much less sanguine about rulemaking developments relating to proxy advisory firms. In this latter regard, it noted investors' concerns that efforts to give companies more input into the advice rendered by proxy advisory firms could weaken the integrity of that advice.[113]

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but that is in reality initiated and controlled by a concealed group or organization . . . ." *Id.* at 6 n. 12, quoting Merriam-Webster, https://www.merriam-webster.com/dictionary/astroturfing.

[109] *Id.* at 17, *quoting* 18 U.S.C. § 1001(a) (2018).

[110] Id. at 3-4. See also U.S. Gov't. Accountability Office, GAO-19-483, Federal Rulemaking: Selected Agencies Should Clearly Communicate Practices Associated with Identity Information in the Public Comment Process 27(June 2019) ("if [SEC] officials are able to confirm that a comment was submitted by someone falsely claiming to be the commenter . . . the comment may not be made available to the public").

[111] 15 U.S.C. § 78d(g)(4).

[112] SEC Investor Advocate Rep. on Objectives for FY 2020 (June 27, 2019), *available at* https://www.sec.gov/files/sec-office-investor-advocate-report-on-objectives-fy2020.pdf ("OIA Objectives Report"). Section 4(g) of the Exchange Act requires the Investor Advocate to file an annual Report on Objectives and an annual Report on Activities with the Senate Committee on Banking, Housing and Urban Affairs and the Committee on Financial Services of the House of Representatives.

[113] OIA Objectives Report at 7.

The OIA addressed these issues again in its recent "Report on Activities" for Fiscal Year 2019.[114] Here the Investor Advocate described the controversy over the role of proxy advisory firms as follows:

> *[C]orporate executives sometimes disagree with the voting recommendations of proxy advisory firms that institutional investors have engaged to provide research and assistance with voting in annual and special meetings. Corporate lobbying groups calling for greater regulation of proxy advisory firms claim that those firms' voting recommendations contain errors and undisclosed conflicts of interest. In an April 8, 2019 speech, the Investor Advocate summarized the prevailing view of institutional investors, which is that the proxy advisory firms perform essential services relatively well, and that there is no market failure warranting further regulatory intervention. . . . Nevertheless, the Commission waded into the fray. On August 21, 2019, the Commission published guidance clarifying the fiduciary obligations of investment advisers in fulfilling their proxy-voting responsibilities. The Commission also published an interpretation concluding that proxy-voting advice provided by proxy advisory firms generally constitutes a "solicitation" under the federal proxy rules, and providing related guidance about the application of the antifraud rule to voting advice. We believe that these interpretive releases may have the effect of inhibiting investment advisers' engagement in proxy voting and, arguably, should have been subject to a notice and comment process.*[115]

ISS is troubled by the fact that the proposal completely ignores the views the Investor Advocate expressed in his April 2019 speech and in the OIA Objectives Report. We urge the Commission to rectify this oversight and accord the Investor Advocate's assessment of investor protection in the proxy adviser context the consideration and respect that Congress intended.

Likewise, we ask the Commission to consider carefully the views of the Investor Advisory Committee ("IAC") which has recommended that the Commission reconsider the Interpretation and Guidance and that it revise and republish this rule proposal to make it more balanced and compliant with the agency's guidance on economic cost-benefit analysis in rulemaking.[116]

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[114] SEC Office of the Investor Advocate, Rep. on Activities for FY 2019, (Dec. 19, 2019), *available at* https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2019.pdf ("OIA Activities Report").

[115] *Id.* at 5-6 (internal citations omitted).

[116] Recommendation from the SEC Investor Advisory Committee (IAC) Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals (Jan. 24, 2020) at 5, *available at* https://www.sec.gov/comments/s7-22-19/s72219-6698769-206000.pdf (noting that instead of showing that a problem with proxy advisers does exist, the PA Proposal merely suggests that problems may or could exist because "some corporate managers and their lawyers and trade group representatives" claim that to be the case). Also created by the Dodd-Frank Act, the IAC is tasked with advising and consulting with the Commission on initiatives to protect investor interests, Exchange Act § 39(a), 15 U.S.C. § 78pp(a).

The text, purpose, history and structure of the Exchange Act and the Advisers Act confirm that proxy advice and proxy solicitation are fundamentally distinct activities that are regulated in different ways. The Commission lacks authority to regulate proxy advice as though it were a solicitation, and its proposed amendment of Exchange Act Rule 14a-1(*l*) is contrary to law. ISS urges the Commission to withdraw this proposal.

6. Additional Comments on Proposed Changes to Rule 14a-1(*l*)

Without waiving or diminishing our challenge to the Commission's authority to regulate proxy advisers under Section 14(a), ISS offers the following comments on certain questions the Commission has asked about its proposed amendment of Rule 14a-1(*l*):[117]

> 2. The SEC proposes to define "proxy voting advice" to include the analysis and research that underlie a vote recommendation and that are delivered to the proxy adviser's clients. However, this term is proposed to exclude research reports and data that are not used to formulate the voting recommendations.[118] It is unclear how the proposal would treat data and research that may inform a proxy analysis and which may be described in a proxy voting research report but are marketed separately to investors. For example, ISS' analytics arm provides investment and governance professionals with a range of content and tools to identify and manage extra-financial risk and fulfill fiduciary obligations involved in active ownership, while its responsible investment arm provides services that help clients integrate responsible investing policies and practices into their strategy and shareholder voting decisions.[119] It would be highly inappropriate to include these stand-alone products and services in the proposed definition of "proxy voting advice" whether or not they play a role in ISS' formulation of vote recommendations.
>
> It is also unclear whether the SEC proposes to stretch the definition of proxy solicitation to cover only advice based on a proxy adviser's benchmark and specialty voting policies, or whether the Commission also intends to cover advice based on investors' custom voting policies. On the one hand, the proposal seems to suggest that

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[117] PA Proposal at 22 - 23, 84 Fed. Reg. at 66523-24. The numbers used herein correspond to the numbering used in the proposal.

[118] *Id*. at 8, n. 11, 84 Fed. Reg. at 66519, n. 11.

[119] These services are described in ISS' Form ADV, which is available through the SEC's website at www.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=579250.

only the benchmark and specialty policies would be swept into the new definition,[120] but the proposal's statements about the importance of advice based on a client's custom voting policy guidelines suggest that the Commission might have a broader interpretation in mind.[121]

Subjecting to issuer oversight our clients' proprietary proxy voting policies and the custom vote recommendations that flow from those policies would add a new dimension to our already strenuous objection to this rulemaking. ISS does not own, and is prohibited from disclosing, clients' proprietary custom voting policies and the recommendations based thereon. Furthermore, there is not even an imaginary trace of investor protection to be gained by allowing issuers to vet the methodologies and assumptions institutional investors choose to implement for their own portfolios. If this ill-advised rulemaking goes forward, we urge the Commission to confirm that proxy voting recommendations and reports based on clients' custom policies are excluded from Rule 14a-1(*l*)(1)(iii)(A).

4. All forms of fiduciary investment advice, including proxy voting advice, should be governed exclusively by the Advisers Act regulatory regime, unless the advice is expressly excepted or exempted from that regime. The Commission's failure to enforce the Advisers Act against a minority of proxy advisers does not justify applying the Exchange Act proxy rules to the whole industry.

5. As explained earlier in this letter, a proxy "solicitation" involves a concerted effort by an interested party to achieve a desired outcome in a matter that is subject to a shareholder vote, consent or authorization. Consequently, the definition of "solicit" and "solicitation" in Rule 14a-1(*l)* should exclude any advice that is rendered to advance the best interest of the shareholder being advised and not to achieve a particular outcome for the corporation in question. This would exclude any voting recommendation made in the context of a fiduciary relationship, including a recommendation that is incidental to an investment adviser's management of a client's portfolio. It also would exclude a recommendation made by a non-fiduciary financial advisor, including a broker-dealer, if that advisor is acting in the customer's best interest. On the other hand, a recommendation made with the intent or purpose of advancing the speaker's own interests

[120] PA Proposal at 18, 84 Fed. Reg. at 66522.

[121] *Id.* at 8, 84 Fed. Reg. at 66519.

or the interests of a third party seeking to "maintain or gain control" of the company, should be treated as a "solicitation" for purposes of Rule 14a-1(*l*).

6. In the Interpretation and Guidance, the Commission tried to reconcile its desire to regulate proxy advisers under Section 14(a) with its long-standing view that a financial advisor acts as a proxy solicitor only if it issues "unsolicited" vote recommendations. Although "unsolicited" in this context has always been defined to mean "over-the-transom" (*i.e.,* advice given to people who have not asked for it), the Interpretation and Guidance said that whether advice is "unsolicited" should depend instead on whether the party rendering that advice markets its expertise in the matter at hand.[122] Perhaps realizing that this construction is at odds with the transactional approach the SEC takes to identifying unsolicited communications in other contexts under the Exchange Act,[123] the Commission now proposes to abandon the concept of unsolicited proxy advice altogether. In its place, the Commission introduces the concept of "unprompted" advice and proposes to except such advice from the definition of "solicitation" under the proxy rules.[124] There are at least three problems with this idea.

First, it is unnecessary, because a party that furnishes voting advice only in response to an "unprompted" client request would not fall under the revised solicitation definition in the first place. Stated otherwise, a party that advises solely in response to unprompted requests, does not market its expertise and sell voting advice for a fee.

Second, it is unworkable, because an investment adviser who announces its willingness to provide voting advice to its managed accounts (as Form ADV requires it to do), or a broker-dealer who makes a similar disclosure to retail investors in Form CRS, would run the risk of having the SEC determine that it has "invited and encouraged" its clients to ask for advice.

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[122] Interpretation and Guidance, *supra* note 2 at 10, 84 Fed. Reg. 47419.

[123] For example, Regulation Best Interest imposes a heightened standard of conduct on a broker-dealer who recommends securities transactions to retail customers. Exchange Act Rule 15*l*-1. In adopting this rule, the Commission confirmed that the duty to act in a retail customer's best interest does not apply to "unsolicited orders," even if the broker has made other recommendations to the same client. *Regulation Best Interest: The Broker-Dealer Standard of Conduct,* Exchange Act Rel. No. 86031 (June 5, 2019) at 76-77, 84 Fed. Reg. 33318, 33334-33335 (July 12, 2019). The Commission did not condition this position on a broker's eliminating or restricting its sales and marketing activities. Likewise, certain Exchange Act transaction reporting requirements differentiate between "solicited" and "unsolicited" customer orders without regard to how the customer relationship was established. Rule 17a-25(a)(2)(ii).

[124] Proposed Rule 14a-1(*l*)(2)(v); PA Proposal at 20, 84 Fed. Reg. at 66523.

Finally, it is counterproductive. Subjecting experts who have the skill and resources to provide accurate and independent proxy advice to additional regulation, while allowing others, with no relevant expertise, to furnish *ad hoc*, "drive-by" advice belies the asserted investor protection goal of this rulemaking,

For these reasons, the proposed amendment of Rule 14a-1(*l*)(2) should be dropped.

B. The Exemptive Component;
Proposed Changes to Rule 14a-2(b)

The Commission proposes to add three new conditions to two existing exemptions from the filing and information requirements of the proxy rules. The first exemption (found in Rule 14a-2(b)(1)) is the one the SEC adopted in 1992 as a safe harbor for shareholders and others who do not seek proxy authority on their own or another's behalf and who do not have a substantial interest in the matter subject to shareholder action beyond their interest as shareholders or employees.[125] The second exemption (found in Rule 14a-2(b)(3)) is the one the Commission adopted in 1979 for financial advisors who go beyond their advisory function and voluntarily distribute proxy voting advice to persons who have not asked for it.[126] Although the SEC contends that proxy advisers have traditionally relied on these exemptions, that is not so. Until the Commission issued the contested Interpretation and Guidance in August 2019, fiduciary proxy advice furnished to investors pursuant to contract and for a fee was not deemed to be a proxy solicitation. Thus, proxy advisers have never needed an exemption from the filing and information requirements of the proxy rules.

The conditions the Commission proposes to add to these exemptions would apply exclusively to proxy advisers and would be housed in a new subsection (b)(9) of Rule 14a-2. The first condition—to be added as 14a-2(b)(9)(i)—relates to conflict of interest disclosures. The second condition—to be added as 14a-2(b)(9)(ii)—would give public companies two opportunities to review proxy advisers' advice and one opportunity for feedback before that advice is delivered to the clients who paid for it. The final condition—to be added as 14a-2(b)(9)(iii)—would give public companies the right to have hyperlinks to their own views on the proxy advice inserted into the body of that advice and any electronic medium used to deliver the advice. The condition on conflicts largely duplicates existing requirements under the Advisers Act. The issuer review and

[125] *See supra* at 13 -15.

[126] *Supra* at 13.

content insertion are the real purposes of this rulemaking, and are designed to provide corporate insiders with the editorial control over proxy advice they have sought for so long.

Although the SEC claims that these changes are necessary to address "concerns" about the integrity and accuracy of proxy advisers' analyses and recommendations, there are no legitimate concerns in either of these areas.

1. This rulemaking is a solution in search of a problem.

a. Conflicts of Interest

ISS strongly agrees that proxy advisers should take meaningful steps either to eliminate, or to manage and disclose all conflicts of interest that might incline the proxy adviser to render advice that is not disinterested. As discussed above, conflict elimination, management and disclosure are the heart and soul of an investment adviser's fiduciary duty of loyalty.[127] The SEC addressed the application of this duty in the context of proxy voting and the use of third-party proxy advisers when it adopted Advisers Act proxy rule in 2003[128] and again in 2019 when it issued extensive guidance on this topic.[129]

ISS addresses conflicts of interest, first and foremost, by being a transparent, policy-based organization. Its use of a series of published voting policies provides a very practical check and balance that ensures the integrity and independence of ISS' research and vote recommendations. The existence of a published analytical framework, coupled with the fact that vote recommendations are based on publicly-available information, allows ISS clients to continuously monitor the integrity and consistency of ISS advice.

Furthermore, ISS has undertaken comprehensive risk assessments to identify specific conflicts of interest related to its operations and has adopted controls reasonably designed to

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[127] *Supra* at 22.

[128] Advisers Act Proxy Rule Release, *supra* note 69.

[129] *Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers,* Advisers Act Rel. No. 5325 (Aug. 21, 2019), 84 Fed. Reg. 47420 (Sept. 10, 2019), available at http://www.sec.gov/rules/interp/2019/ia-5325.pdf. Over the years, the SEC Staff have also provided guidance on investment advisers' obligations to address conflicts in connection with proxy advisory services. Letter from Douglas Scheidt, Assoc. Dir., SEC Div. of Inv. Mgmt. to Mari-Anne Pisarri, Pickard and Djinis LLP, Counsel for Institutional Shareholder Services Inc., 2004 SEC No-Act. LEXIS 736 (Sept. 15, 2004) at *4-5, *withdrawn by* IM Information Update, Statement Regarding Staff Proxy Advisory Letters, IM-INFO 2018-02 (Sept. 2018) available at: https://www.sec.gov/divisions/investment/imannouncements/im-info-2018-02.pdf; SEC Div. of Inv. Mgmt., Div .of Corp. Fin., *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms,* Staff Legal bulletin No. 20 (June 30, 2014), *available at* http://www.sec.gov/interps/legal/cfslb20.htm.

manage each of those risks.[130] ISS conducts a range of transactional and forensic tests to assess the sufficiency of its compliance procedures and the effectiveness of their implementation.

i. Conflicts of Interest in Connection with Affiliated Corporate Services

The most talked-about ISS potential conflict of interest relates to the fact that one of our subsidiaries, ISS Corporate Solutions, Inc. ("ICS"), provides governance tools and services to corporate issuer clients. Without adequate safeguards, this could potentially result in vote recommendations that are biased in favor of corporate management. However, the fact that the most vocal critics of ISS in this area are those who speak on behalf of corporate management, and not the investors who rely on ISS' research and vote recommendations, indicates that ISS is managing this potential conflict extremely well. The primary control for this risk is the firewall ISS maintains between the core institutional business and the ICS business. This firewall includes the physical and functional separation between ICS and ISS, with a particular focus on the separation of ICS from the ISS Global Research team. A key goal of the firewall is to keep the ISS Global Research team from knowing the identity of ICS' clients, thereby ensuring the objectivity and independence of ISS' research process and vote recommendations. The firewall mitigates potential conflicts via several layers of separation:

- ICS is a separate legal entity from ISS.
- ICS is physically separated from ISS, and its daily operations are separately managed.
- ISS Global Research team works independently from ICS.
- ICS and ISS staff are forbidden to discuss the identity of ICS clients.
- Institutional analysts' salaries, bonuses and other forms of compensation are not linked to any specific ICS activity or sale.
- ICS explicitly tells its corporate clients and indicates in their contracts that ISS will not give preferential treatment to, and is under no obligation to support, any proxy proposal of an ICS client. ICS further informs its clients that ISS' Global Research team prepares its research and vote recommendations independently of, and with no involvement from, ICS.

ISS maintains a robust training and monitoring program regarding the firewall. This program includes quarterly tests of the firewall's integrity, new-hire orientation, and review of certain marketing materials and disclosures. There also is an ethics hotline available to both ICS and ISS staff for reporting issues of potential concern.

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[130] See Advisers Act Rule 206(4)-7; *Compliance Programs of Investment Companies and Investment Advisers,* Advisers Act Rel. No. 2204 (Dec. 17, 2003) at 5, 68 Fed. Reg. 74714, 74716 (Dec. 24, 2003) ("Each adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks"). *See also* 2016 GAO Report, *supra* note 3 at 9.

ii. Conflicts of Interest in Connection with ISS' Owner and Directors

ISS is a privately-held company, whose owner, along with company management, is Genstar Capital, LLC, a private equity firm. ISS has complete independence from Genstar Capital in the development and application of its voting policies, the preparation of proxy research and the formulation of vote recommendations. The Board of Directors of ISS has formally adopted a Policy on Potential Conflicts of Interest Related to Genstar Capital and its affiliated funds.[131]

In addition, as a private equity firm that owns or controls a number of operating companies, some of which may become publicly traded and may thereafter be the subject of ISS research, actual or potential conflicts of interest, or the appearance of conflicts, could arise in the production of research and vote recommendations with respect to coverage of such a Genstar company (i.e., a "Genstar Affiliated Company"). ISS therefore provides disclosure of these relationships on its website and will include information about any such relationship in the research report for an issuer that is a Genstar Affiliated Company. Similarly, the ISS Board of Directors has adopted procedures and safeguards to identify and disclose any actual or potential conflict of interest situations involving service by an ISS Director on the board of a publicly-traded issuer, or in another capacity (relative to an issuer), that could present the potential for a conflict.[132]

iii. Conflicts of Interest Within the Institutional Advisory Business

Potential conflicts of interest also may arise where an ISS institutional investor client is, itself, a public company whose shareholder meetings are the subject of research and voting recommendations or where ISS is called upon to analyze and make vote recommendations on shareholder proposals propounded by an ISS client. ISS' fiduciary commitment to act in the best interests of each investor client, its development of vote recommendations in accordance with applicable published or custom voting policies, and the ongoing scrutiny it receives from its institutional clients effectively address this potential conflict, as does the disclosure of "significant relationships" as described in more detail below.

iv. Conflicts of Interest at the Employee Level

Potential conflicts of interest also may arise in connection with an employee's personal securities investments, the receipt or giving of gifts and entertainment, or contacts with proxy solicitors and other interested parties. ISS has implemented specific policies and procedures in each of these areas to manage any potential conflicts. These include procedures for preclearance of

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[131] https://www.issgovernance.com/file/duediligence/ISS-Conflicts-Policy-Regarding-Genstar.pdf.

[132] https://www.issgovernance.com/file/duediligence/ISS-Board-of-Directors-Conflicts-Policy.pdf.

personal trades, blackout periods for trading in stocks of issuers whose meetings are currently being analyzed or acted upon, and extensive personal trade reporting requirements.[133] ISS also restricts employees' ability to give or receive business-related gifts and entertainment, and it has a strict policy addressing interactions between ISS staff and proxy solicitors or other parties that represent issuers, dissident shareholders or other external parties soliciting proxies from shareholders, in order to ensure that such interactions do not compromise the independence of the advice ISS renders to its clients.[134]

v. Conflicts of Interest in Connection with Issuers' Review of Draft Reports

In select markets and under certain circumstances, ISS currently and voluntarily affords some issuers an opportunity to review draft reports for factual accuracy prior to publication. This practice presents a risk (which would be magnified many times over by the proposed rule amendments) that the subjects of ISS' advice will have an undue influence on the content of that advice. In order to ensure the propriety of all such interactions between an issuer and ISS analysts, any decision by an analyst to change a draft vote recommendation based on an issuer's notification of one or more factual errors in a draft report must be reviewed by a senior analyst and appropriate records must be kept of the communication from the issuer and the voting decision. These records are subject to the Chief Compliance Officer's periodic review.

vi. Disclosure Regarding Potential Conflicts of Interest

ISS already provides its investor clients with an extensive array of information to ensure that they are fully informed of potential conflicts and the steps ISS has taken to address them. In addition to making full disclosure in the Form ADV brochure it delivers to each client, ISS supplies a comprehensive due diligence compliance package on the "Compliance" section of its web site to assist clients and prospective clients in fulfilling their own obligations regarding the use of proxy advisory services.[135] This package includes a copy of ISS' Code of Ethics, a description of other policies, procedures and practices regarding potential conflicts of interest and a description of the ICS business.

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[133] *See Personal Trading Policy* in ISS Code of Ethics at 8, *available at* https://www.issgovernance.com/file/duediligence/code-of-ethics-nov-2019.pdf.

[134] See ISS, Policy on Interactions and Communications with Proxy Solicitors and Other Proxy Advisory Companies, Id. at 14.

[135] *See* ISS, *Due Diligence Package: Proxy Research and Voting Services* (last updated October 14, 2019) available at: https://www.issgovernance.com/compliance/due-diligence-materials/ ("Due Diligence Package").

Moreover, each proxy analysis and research report ISS issues contains a legend indicating that the subject of the analysis or report may be a client of or affiliated with a client of ISS, ICS or another ISS subsidiary. Each analysis and report also notes that one or more proponents of a shareholder proposal may be a client of ISS or one of its affiliates, or may be affiliated with such a party. Although investment advisers typically disclose conflict of interest information at a macro level,[136] ISS goes further. Any institutional client that wishes to learn more about the relationship, if any, between ICS and the subject of a particular report may access this information through the ProxyExchange platform and/or by contacting ISS' Legal and Compliance Department for relevant details. These processes allow ISS' proxy voting clients to receive the names of ICS clients, the amount that any ICS client has paid ICS and the particular products/services they purchased, and all this is done without revealing that information to ISS' research analysts as they prepare the research and vote recommendations. Were the ICS relationship identified on the face of a proxy research report, this critical information barrier would be destroyed.

Research reports also contain disclosure regarding any engagement ISS may have had with the company or other relevant market participant as part of the analysis. This may include key information disclosed in dialogue with companies, shareholder proponents or other stakeholders, including the date(s) of dialogue, the topic(s) covered, the initiator of the dialogue and the outcome of the dialogue.

Furthermore, detailed disclosure of potential conflicts of interest is available to clients through ISS' ProxyExchange platform in a way that both seamlessly integrates with clients' workflows and protects the critical firewall between ISS and its ICS subsidiary. In this regard, the platform reveals the existence of any "significant relationship" between ISS and a registrant, an institutional client affiliated with a registrant or a primary shareholder proponent of a proposal subject to ISS' advice, and users can click through on a link to get more information about that relationship. For purposes of this disclosure, ISS deems any paying client relationship between ICS and a corporate issuer, where ISS provides proxy vote recommendations and research regarding that issuer to be "significant." A relationship with an ISS institutional client who is itself, or who is related to, a corporate issuer will be deemed "significant" if annual revenues from that client are in excess of 5% of ISS' total, consolidated revenues for the most recently completed fiscal year. The same 5% test applies in the case of relationships with clients who act as primary filers of shareholder proposals.

In addition to obtaining report-by-report conflict information, institutional clients of ISS can obtain lists of all ICS clients. Some clients receive such lists on a monthly basis, while others receive

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[136] *See, e.g.* Form ADV, Part 2A, Item 11.

the lists on a quarterly or annual basis. This is just one of the many steps institutional investors take to reassure themselves that ISS is appropriately mitigating conflicts. They also obtain a range of additional information regarding our information barriers, our information security program, and other aspects of our operations. Many clients meet with ISS staff on an annual basis to discuss conflict mitigation policies and practices and other due diligence matters.

ISS' careful attention to conflict mitigation and disclosure appears to be effective.

The issue of proxy adviser conflicts of interest was extensively discussed at the 2018 Roundtable on the Proxy Process. Participants acknowledged the importance of monitoring the steps proxy advisory firms take to ensure the integrity of their reports and recommendations, and the consensus among the consumers of proxy advice was that this process is working as it should. For example, Jonathan Bailey, Managing Director and Head of ESG Investing, Neuberger Berman, LLC, said:

> *We have seen no evidence that there has been any impact from conflicts of interest on the services provided to us, and we feel comfortable with the level of disclosure that we get. And on an annual basis, we review that with our chosen service providers, and will continue to do so.*[137]

Likewise, Patti Brammer, Corporate Governance Officer, Ohio Public Employees Retirement System said:

> *I would just say that I can speak to -- our experience has been that yes, the conflict disclosure is very easy to understand. It's not boilerplate language. It does provide sufficient detail, and it is an element that we use and consider.*[138]

And Scot Draeger, Vice President, Director of Wealth Management, General Counsel and Chief Compliance Officer, R.M. Davis Private Wealth Management agreed, noting:

> *I would say, as a practical matter, to speak as a user of the service, for a proxy advisory firm service, the disclosures are ones that are easy to understand at present, and aren't dissimilar from an auditor independence.*
>
> *……*
>
> *[T]he transparency of the conflicts themselves are disclosed seemingly pretty well. If you're a user -- for ISS, anyway, is what I can speak to -- there's a dashboard that you go into. It's a very technical point. But when you're looking down and you're making decisions about votes or categories of votes, with respect to every issuer there's a box on the dashboard that says "Conflict" that you can literally click on and get the information that was described.*[139]

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[137] 2018 Roundtable Transcript, *supra* note 76 at 212.

[138] *Id.* at 213.

[139] *Id.* at 211.

Although the SEC acknowledges that proxy advisers have implemented extensive policies and procedures to identify, manage and disclose conflicts of interest, and that proxy advisers' clients have expressed satisfaction with advisers' practices in this regard, the agency says more regulation is needed because certain issuers and their paid representatives are still not satisfied.[140] It is an understatement to say that public companies' views on conflicts of interest in this context should be taken with a grain of salt.

Unlike institutional investors who choose to use proxy advisory services to help fulfill their fiduciary duties to shareholders and beneficiaries, certain public companies view proxy advisers as adversaries whose vote recommendations can sometimes interfere with management's views or economic self-interest. Furthermore, because investor subscribers to proxy advisory services have access to detailed disclosures of potential conflicts of interest and the opportunity to conduct comprehensive due diligence on their proxy advisers' policies and procedures, they are far better equipped than issuers are to assess whether existing regulations are sufficient to protect investors.

Finally, given that certain issuers, their corporate advisers and lobbyists are the source and most vocal advocates of the proposal to inject a grave new conflict of interest into proxy advisers' research and advice through compelled issuer review of not only factual statements but also of proxy advisers' methodologies and opinions, issuers' "concern" about conflicts of interest has a hollow ring. And their much-ballyhooed interest in transparency is belied by the apparent orchestration by some of a campaign of sham comments from "retail investors."

The SEC states that its primary concern in proposing these amendments is with the recipients of proxy voting advice,[141] but then it largely ignores the views of those parties (and the fact that such advice is already regulated under the Advisers Act). ISS respectfully submits that basing this rulemaking on concerns expressed by a group of self-interested corporate insiders and their lobbyists, while dismissing the views of the fiduciaries who use proxy advice to serve the best interests of their shareholder clients would be arbitrary, capricious and an abuse of the Commission's discretion.

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[140] PA Proposal at 28, n. 76, 29 n. 78 and 30 n. 82, 84 Fed. Reg. at 66525 n. 76 and 66526 nn. 78 & 82. The Commission also asserts that new regulation under the Exchange Act is necessary because there is "no uniform set of standards" applicable to the policies and procedures proxy advisers adopt to address the risks posed by conflicts of interest. *Id.* at 28 n. 76, 84 Fed. Reg. 66525 n. 76. This statement assiduously ignores the robust set of fiduciary standards that today govern 60% of U.S. proxy advisers and should be applied to the whole industry. As amply demonstrated above, the regulatory regime established under the Advisers Act needs no help from the Exchange Act proxy rules.

[141] *Id.* at 34, n. 91, 84 Fed. Reg. at 66527, n.91.

b. Accuracy

As it stands today, the overwhelming majority of proxy votes are cast in favor of corporate management. Certain public companies seek to close even the modest window of dissent by urging the Commission to let them play an active role in crafting the advice investors receive from their chosen proxy advisory firms. In order to justify this extraordinary request, these members of the registrant community and their cadre of overt and concealed representatives have launched a campaign of concern about "factual errors, incompleteness, or methodological weaknesses" in the advice proxy advisers render to their clients.[142] These concerns are no more legitimate than are issuers' claims of concerns about proxy advisers' conflicts of interest.

In 2016, the GAO examined the issue of accuracy at the behest of Congress and reported:

> *Both corporate issuers and institutional investors we interviewed said that the data errors they found in the proxy reports were mostly minor.*[143]

The consumers of proxy voting advice offered the same assessment at the 2018 Roundtable, with one participant saying:

> *I think there's a very important distinction to be made between objective factual errors and subjective interpretation and policy. And we find a small, very small, number of objective factual errors, and we think those are dealt with and need to be dealt with.*[144]

The SEC's Investor Advocate recently told Congress:

> [W]*e reviewed many of the alleged 'errors' and determined that most would be more appropriately characterized as differences of opinion.*[145]

And one corporate issuer, who also operates in the financial services industry, echoed similar sentiments:

> *Proponents of additional regulatory requirements for proxy advisory firms have raised concerns regarding the accuracy of proxy advisor reports, and suggested that issuers should be permitted to review and comment on proxy reports before the reports are shared with the proxy advisors' clients. From T. Rowe Price' s perspective as a corporate issuer, we appreciate having effective ways to address factual errors in proxy advisor research reports and find current practices, including the ability to file amended proxy*

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[142] *Id.* at 39, 84 Fed. Reg. at 66528.

[143] 2016 GAO Report, *supra* note 3 at 29.

[144] Remarks of Jonathan Bailey, 2018 Roundtable Transcript, *supra* note 76 at 238.

[145] OIA Activities Report, *supra* note 114 at 5 - 6. *See also* Remarks of Anne Sheehan, Director of Corporate Governance, CalSTRS, 2013 Roundtable Transcript, *supra* note 102 at 155 ("What I have found, that many times the errors are really differences of opinion").

statements with the SEC, to be sufficient. As described during the roundtable, both ISS and Glass Lewis, the largest proxy advisory firms operating in the US, have transparent mechanisms in place for issuers to address any factual errors in their data analyses.[146]

The extremely low error rate for proxy advice is not an accident. As with conflict mitigation and disclosure, proxy advisers go to great lengths to ensure the accuracy of the information that underpins their advice; it is in their interest to do so. Among the many steps ISS has taken to ensure quality and minimize errors in its published research are the following:

- Reports and recommendations are driven by publicly available information and based on publicly disclosed and detailed voting policy guidelines.
- Issuer data used by ISS is consistently collected, classified and subject to quality control review before it is used by ISS' analysts.
- Prior to finalization and delivery to clients, each proxy research report is subject to internal review for accuracy, quality and to ensure that the relevant voting policy has been correctly applied.
- ISS maintains a data verification platform which allows issuers to verify key data underlying ISS' evaluation of equity-based compensation plans, thereby providing ISS clients with greater assurance of data integrity.
- In select markets and under certain circumstances, companies may receive an opportunity to review a draft analysis for factual accuracy prior to publication of the analysis.[147]
- All issuers may request and receive, at no charge, a copy of the published ISS benchmark research report, including the vote recommendations in advance of its shareholder meeting.
- In the event new material public information becomes available or if ISS finds that a report contains a material error, ISS promptly issues a Proxy Alert ("Alert") to inform clients of any corrections and, if necessary, any resulting changes in the vote recommendations. Alerts are distributed to ISS' investor clients through the same ProxyExchange platform used to distribute the regular research and voting recommendations. This ensures that the clients who received an original report will also receive the related Alert, which is attached to the relevant original company meeting report. Even if a client has cast its vote before receiving an Alert, the client may cancel and change its vote at any time before the meeting cut-off date, if the client determines that such a change is warranted by the new information.

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[146] Letter from Donna F. Anderson and Eric Veiel, T. Rowe Price, to Brent J. Fields, Esq., Secretary, SEC (Dec. 13, 2018) ("2018 T. Rowe Price Letter") at 2.

[147] See *infra* at 61-62.

- ISS maintains a Feedback Review Board ("FRB"), which I oversee as ISS' President and CEO. The FRB serves as an additional channel for issuers or others to communicate with ISS any unresolved concerns regarding accuracy of research, accuracy of data, policy application and general fairness of ISS policies, research, and recommendations.

- ISS conducts regular SSAE 18 audits to check compliance with internal control processes. Controls around ISS' research process are included in these audits.

Many supporters of the proposed rulemaking rely on a 2018 study by the American Council on Capital Formation ("ACCF") to bolster their "concerns" about inaccurate proxy advice,[148] but this study has been thoroughly discredited. After painstakingly analyzing each of the 139 purported "proxy advisor errors" identified by the ACCF, the Council of Institutional Investors ("CII")—a nonprofit, nonpartisan association of U.S. asset owners with combined assets of $4 trillion—concluded that:

> *[I]t is clear that most of the claimed 'errors' actually are disagreements on analysis and methodologies, and that some other alleged proxy advisory firm errors derive from errors in the company proxy statements.* [149]

The CII also reviewed claims about inaccurate proxy advice made by parties such as the Business Roundtable, the National Investor Relations Institute, the National Association of Manufacturers and the U.S. Chamber of Commerce Center for Capital Markets Competitiveness and found "evidence of pervasive proxy advisor inaccuracy [to be] extraordinarily weak."[150]

On the subject of errors, we note the January 16, 2020 Memorandum from the SEC's Division of Economic and Risk Analysis ("DERA") which explains the methodology behind a table DERA purportedly created to "provide a tabular approximation of the number of instances registrants indicated 'concerns' over the 2016-2018 period with respect to proxy voting advice in the additional soliciting materials reviewed by the staff."[151] The DERA Memorandum rightfully

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[148] Frank Placenti, *Are Proxy Advisors Really A Problem?,* American Council for Capital Formation (Oct. 29, 2018) 10-11 *available at* http://accf.org/2018/10/29/are-proxy-advisors-really-a-problem/. Even taken at face value, this study identifies an error rate of only 0.4%, which hardly justifies this rulemaking.

[149] Letter from Kenneth A. Bertsch, Executive Director, CII (Oct. 24, 2019, incorporating Oct. 25, 2019 corrections) ("2019 CII Letter"), at 2.

[150] *Id.* at 7.

[151] DERA, Memorandum to File S-7-22-19 regarding "Data analysis of additional definitive proxy materials filed by registrants in response to proxy voting advice" (Jan. 16, 2020), *available at* *https://www.sec.gov/comments/s7-22-19/s72219-6660914-203861.pdf* ("DERA Memorandum").

recognizes that reviewers of the various filings may reach different conclusions about the classifications of the concerns. This critical observation underscores a key point that we have witnessed directly at ISS and which other commentators have expressed as noted above, namely the critical distinction between objective factual errors and issues of subjective interpretation or differences of opinions on methodological frameworks. To test this observation in the context of the table in the rulemaking proposal and given the limited time afforded to us after the issuance of the DERA Memorandum, ISS performed a focused assessment of the 84 filings cited by DERA that were made in 2018. Of the 84 filings, five related exclusively to proxy research reports issued by Glass Lewis and so we did not assess those. Of the remaining 79, over 90% of the cited filings did not even state a claim of factual errors but instead reflected an issuer's disagreement with the opinions reached by ISS and/or the methodological framework(s) used by ISS to analyze the issue at hand. In fact, only 4 of the identified filings articulated a clear claim by an issuer of a factual error or inaccuracy on the part of ISS; after carefully reviewing those claims, ISS respectfully disagrees with those issuers' assertions.

Issuers' argument that without the ability to intervene in the production of proxy advice they have no "timely and effective way" to express their disagreement with that advice[152] is also extraordinarily weak. Companies make their views known to investors in a myriad of ways, including in initial and supplemental proxy statements,[153] by hiring proxy solicitors and through individual engagements. As professor John C. Coates, a member of the SEC's Investor Advisory Committee, remarked at a hearing before the Senate Committee on Banking, Housing and Urban Affairs, "[The issuer] has its own mouth too."[154]

Professor Coates went on to rebut the contention that issuer oversight of proxy research is necessary to ensure that accurate information enters the marketplace, saying:

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[152] PA Proposal at 39, 84 Fed. Reg. at 66529.

[153] In fact, issuers "get unlimited space in the proxy statement" to voice their opposition to shareholder proposals, while the proponents of such proposals have a maximum of 500 words to explain their point of view. Remarks of Michael Garland, Assistant Comptroller, Office of the New York City Comptroller, 2018 Roundtable Transcript *supra* note 76 at 160; 17 CFR § 240.14a-8(d).

[154] *Legislative Proposals to Examine Corporate Governance:* Hearing Before the S. Comm. on Banking Housing, and Urban Affairs, 115th Cong. (2018) (Statement of John C. Coates).

> *Anyone giving advice in a public way . . . is subject to anti-fraud rules enforced by the SEC. So, if ISS were to put out a report knowingly falsely, or negligently falsely, they would have liability for it. So I just want to be clear that if they deliberately misrepresent facts, they are going to be subject to liability. . . . On basic factual disputes we have an amply robust system for getting the information out there for investors.*[155]

This is not the first time some issuers have tried to interfere with shareholders' ability to communicate about their proxy votes. In opposing the Commission's 1992 shareholder-friendly package of reforms, the corporate community argued that management should have "'a role to play' in rebutting any misstatements or mischaracterization" in shareholder communications in order to ensure "that proxies are executed on the basis of 'correct' information." The Commission rejected that argument, observing that

> *much commentary concerning corporate performance, management capability or directorial qualifications or the desirability of a particular initiative subject to a shareholder vote is by its nature judgmental. As to such opinions, there typically is not a 'correct' viewpoint.*[156]

The proposal addresses this inconvenient truth by admitting that this rulemaking is not really about accuracy after all, but about giving registrants a say in the methodologies proxy advisers use and the opinions they express:

> *The registrant and certain other soliciting person [sic] may have disagreements that extend beyond the accuracy of the data used, such as differing views about the proxy advisor's methodological approach or other differences of opinion that they believe are relevant to the voting advice.*[157]

This admission reveals a far more serious infirmity with the proposal, which the Commission also identified in 1992:

> *A regulatory scheme that inserted the Commission staff and corporate management into every exchange and conversation among shareholders, their advisors and other parties on matters subject to a vote certainly would raise serious questions under the free speech clause of the First Amendment, particularly where no proxy authority is being solicited by such persons.*[158]

It is not clear why the SEC has had such a radical change of heart between 1992 and now, but one thing is certain: Proposed Rules 14a-2(b)(9)(ii) and (iii) are blatantly unconstitutional.

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[155] *Id.*

[156] 1992 Release, supra note 46, 57 Fed. Reg. at 48278.

[157] PA Proposal at 43-44, 52, 84 Fed. Reg. at 66530, 66533.

[158] 1992 Release, 57 Fed. Reg. at 48279.

2. The proposal is unconstitutional.

Proxy advisers engage in speech at the core of the First Amendment by offering research, analysis, opinions, and recommendations to their clients about matters of critical public importance. Yet the proposal—which, remarkably, does not even *mention* the First Amendment—would commandeer proxy advisers' speech to serve the interests of issuers, and would grant issuers an extraordinary right to review proxy advisers' speech *before they communicate to their own clients*. The proposal also violates the Fifth Amendment's Takings Clause and eviscerates advisers' (and their clients') reliance interests by forcing proxy advisers to share valuable, confidential intellectual property with companies and other parties who have not paid for this information and have no contractual or other relationship with the advisers. The proposed rule amendments flout bedrock constitutional principles and would never pass judicial review if they were to be adopted. The government "may not, under the guise of prohibiting professional misconduct, ignore constitutional rights;"[159] yet that is precisely what the Commission proposes to do.

a. Proxy advisers' research, analysis, opinions and recommendations are core speech protected by the First Amendment.

When proxy advisers provide independent research, analysis, opinions and recommendations to their clients, they engage in speech and expressive activity protected by the First Amendment. The Supreme Court has made clear that "professional speech"—expert advice that clients receive from regulated entities—is not "a separate category of speech that is subject to different rules."[160] The Court's "precedents have long protected the First Amendment rights of professionals."[161] Because professionals may have "a host of good-faith disagreements, both with each other and with the government, on many topics in their respective fields," the government cannot pick winners and losers by burdening only one type of speech or speaker it deems disfavored.[162] Moreover, "when the government polices the content of professional speech," it unconstitutionally stifles the "'uninhibited marketplace of ideas in which truth will ultimately prevail.'"[163]

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[159] *NAACP v. Button*, 371 U.S. 415, 439 (1963).

[160] *NIFLA v. Becerra*, 138 S. Ct. 2361, 2371 (2018).

[161] *Id.* at 2374.

[162] *Id.* at 2374-75.

[163] *Id.* at 2374 (quoting *McCullen v. Coakley*, 573 U.S. 464, 476 (2014)).

Proxy advisers' speech and expression are at the core of the First Amendment's protections. Before proxy advisers like ISS entered the market, institutional investors often followed the so-called Wall Street Rule ("vote with management or sell") because it was too expensive and time-consuming to inform themselves about thousands of shareholder votes across all the companies in their investment portfolios.[164] Proxy advisers offer investors independent research, analysis, and recommendations to empower them to make better-informed decisions about how to vote on matters requiring shareholder approval, and to ensure they have "the information needed to hold corporations … accountable."[165]

Proxy advisers' speech, research, analysis, opinions and recommendations address matters of critical importance, including corporate transactions such as mergers and acquisitions, executive compensation, and a company's corporate governance policies. Proxy advisers may also offer their views about the extent to which corporate ballot measures comport with an investor's selected voting priorities regarding sustainability, labor relations, social responsibility, or other investor-specific criteria. In short, proxy advisers' research, analysis, opinions, recommendations and advice to their clients regarding corporate ballot proposals are unquestionably "form[s] of expression protected by the Free Speech Clause of the First Amendment."[166]

b. The inserted response provision of proposed Rule 14a-2(b)(9) imposes content-, speaker- and viewpoint-based burdens on protected speech that cannot satisfy any level of First Amendment scrutiny.

Proposed Rule 14a-2(b)(9)(iii) would force proxy advisers to include a hyperlink in their advice to clients directing the client to "a written statement prepared by the registrant that sets forth its views on the advice."[167] The assumption behind this proposal is that the issuer's views

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[164] George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 Mich. St. L. Rev. 1287, 1288 (2014).

[165] *Citizens United v. FEC*, 558 U.S. 310, 370 (2010).

[166] *Sorrell v. IMS Health*, 564 U.S. 552, 557 (2011); *see also NIFLA*, 138 S. Ct. at 2371-75 (crisis pregnancy centers had First Amendment right in the messages they conveyed, or did not convey, to their patients); *Button*, 371 U.S. at 438 (First Amendment protects advice from attorneys to potential litigants about seeking legal assistance); *Legal Svcs. Corp. v. Velasquez*, 531 U.S. 533, 545 (2001) (a ban on "the analysis of certain legal issues" effectively "prohibits speech and expression"); *id.* at 546 (First Amendment implicated by law that impaired "the adequacy and fairness of professional representations"); *Bhd. of R.R. Trainmen v. Va. State Bar*, 377 U.S. 1, 7 (1964) (injunction prohibiting union from advising injured workers to obtain legal advice violated First Amendment); *Conant v. Walters*, 309 F.3d 629, 636 (9th Cir. 2002) ("physician speech is entitled to First Amendment protection").

[167] PA Proposal at 53, 84 Fed. Reg. at 66533.

will *contradict* those of the proxy adviser; after all, the issuer would have no incentive to add a statement to advice it agreed with. The Commission expressly anticipates that publicly traded companies will use the hyperlink to voice "disagreements over facts and opinions" and to address purported "factual errors and methodological weaknesses" in the proxy adviser's advice.[168] The purpose of the hyperlink requirement, the Commission explains, is "ensuring that [investors] are able to consider registrants' views.[169] The Commission's attempt to commandeer proxy advisers' reports and systems in order to relay information that *contradicts* the advisers' own recommendations is an extraordinary burden on protected speech that cannot withstand any level of First Amendment scrutiny.

The First Amendment "requires heightened scrutiny whenever the government creates 'a regulation of speech because of disagreement with the message that it conveys.'"[170] Similarly, a law must satisfy strict scrutiny if it is "directed at certain content" or "aimed at particular speakers."[171] Strict scrutiny of the proposed response provision would be warranted because the provision targets particular *speakers* (proxy advisers) and particular *content* (proxy research and voting recommendations) based on the Commission's disagreement with the *message* or *viewpoint* of that speech (*e.g.*, its assumption that proxy advisers' speech is somehow inaccurate or insufficient and needs to be corrected or supplemented by issuers and certain other solicitors). That is the very definition of a content-based and speaker-based restriction on speech.[172] The fact that the regulated speech "results from an economic motive," does not reduce the level of scrutiny that applies to a content- and speaker-based restriction.[173]

Moreover, the Supreme Court has held that laws or regulations that force speakers to include supplemental notices or disclaimers are "content-based regulation[s] of speech."[174] "By compelling individuals to speak a particular message," such requirements "'alte[r] the content of

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[168] *Id.* at 56, 67, 84 Fed. Reg. 66534, 66537.

[169] *Id.* at 53, 84 Fed. Reg. at 66333.

[170] *Sorrell*, 564 U.S. at 566, (quoting *Ward v. Rock Against Racism,* 491 U.S. 781, 791 (1989)).

[171] *Id.* at 567.

[172] *Id.*; *see also Reed v. Town of Gilbert*, 135 S. Ct. 2218, 2226, 2227 (2015) (law is content-based if it "target[s] speech based on its communicative content" or "defin[es] regulated speech by particular subject matter").

[173] *Sorrell*, 564 U.S. at 567.

[174] *NIFLA*, 138 S. Ct. at 2371.

… speech.'"[175] Coerced speech is every bit as unconstitutional as coerced silence, as "the First Amendment guarantees … the decision of both what to say and what *not* to say."[176] "Whenever the Federal Government … compels [individuals] to voice ideas with which they disagree," it "undermines" both "our democratic form of government" and "the search for truth."[177] Indeed, coercive disclosure requirements are particularly suspect under the First Amendment because they allow the government to favor certain speakers or messages over others.[178] Requirements that speakers convey certain messages also "impermissibly require[] [individuals] to associate with speech [and speakers] with which [they] may disagree."[179]

Content-based disclosure requirements such as the one the SEC proposes to add to Rule 14a-2(b) must satisfy "strict scrutiny."[180] Such laws "'are presumptively unconstitutional and may be justified only if the government proves that they are narrowly tailored to serve compelling state interests.'"[181] Forcing a speaker to include *opposing viewpoints* within its own speech could never satisfy strict scrutiny. Because a "[g]overnment-enforced right of access inescapably 'dampens the vigor and limits the variety of public debate,'" "any such compulsion" to "print that which [the speaker] would not otherwise print" is "unconstitutional."[182]

Forcing proxy advisers to facilitate the distribution of issuers' opposing views alongside their own speech is strikingly similar to other laws and regulations that courts have struck down under the First Amendment. The government can no more require proxy advisers to include within their own speech criticisms of their advice than it can

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[175] *Id*. (*quoting Riley v. Nat'l Fed'n of the Blind of N.C., Inc*., 487 U.S. 781, 795 (1988)).

[176] *Riley*, 487 U.S. at 796-97.

[177] *Janus v. AFSCME*, 138 S. Ct. 2448, 2464 (2018).

[178] *NIFLA*, 138 S. Ct. at 2378; *Reed*, 135 S. Ct. at 2229.

[179] *Pac. Gas & Elec. Co. v. Pub. Utilities Comm'n of Calif.*, 475 U.S. 1, 15 (1986).

[180] *NIFLA*, 138 S. Ct. at 2371 (citing *Reed*, 135 S. Ct. at 2226); *accord Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 642 (1994) ("Laws that compel speakers to utter or distribute speech bearing a particular message are subject to [strict] scrutiny."). Note that compelling proxy advisers to disclose dissenting views in their proxy voting research reports is readily distinguishable from mandating conflict of interest disclosures under the federal securities, which, under some circumstances, may receive a lower level of First Amendment scrutiny. *SEC v. Wall Street Publishing Institute,* 851 F.2d 365, 372-73 (D.C. Cir. 1988).

[181] *NIFLA*, 138 S. Ct. at 2371 (quoting *Reed*, 135 S. Ct. at 2226).

[182] *Miami Herald Pub. Co. v. Tornillo*, 418 U.S. 241, 256-57 (1974).

- require a utility company to "include in its billing envelopes speech of a third party with which the utility disagrees;" [183]
- require a newspaper to "grant[] a political candidate a right to equal space to reply to [its] criticism and attacks on his record."[184]

As Justice Kennedy emphasized in *NIFLA*, "[g]overnments must not be allowed to force persons to express a message contrary to their deepest convictions," and "it is not forward thinking to force individuals to 'be an instrument for fostering public adherence to an ideological point of view [they] fin[d] unacceptable."[185]

The Commission's goal of "offer[ing] … a greater variety of views" by "assist[ing] groups … that challenge" proxy advisers' advice is not a compelling state interest; it is unconstitutional viewpoint discrimination.[186] That is because "[t]he variety of views that the Commission seeks to foster cannot be obtained by including speakers whose speech agrees with [the proxy adviser's]. [It] exists only where the relevant groups … disagree with [the proxy adviser's] views."[187] While the government might have a legitimate interest in "making a variety of views available" via regulations that are "content neutral," it does not have a legitimate interest in "abridg[ing] [one side's] rights in order to 'enhance the relative voice' of its opponents."[188]

The response provision cannot be justified on the grounds that it merely requires proxy advisers to publish *additional* or *supplemental* information provided by issuers and thus does not limit their *own* speech. The Supreme Court has flatly rejected the notion that coerced speech can be justified on the ground that the compelled speaker "'is not prevented … from saying anything it wishe[s].'"[189] As the Court explained, a law that requires speakers to include certain messages within their speech "operates as a command in the same sense as a statute or regulation forbidding [the speaker] to publish specified matter."[190]

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[183] *Pac. Gas*, 475 U.S. at 4.

[184] *Miami Herald*, 418 U.S. at 243.

[185] *NIFLA*, 138 S. Ct. at 2379 (Kennedy, J., concurring).

[186] *Pac. Gas*, 475 U.S. at 12-13.

[187] *Id.* at 13.

[188] *Id.* at 20, 14.

[189] *Miami Herald*, 418 U.S. at 256.

[190] Id.

Nor can the response provision be saved by analogizing it to the so-called "fairness doctrine," a now-defunct policy imposed by the Federal Communications Commission that required broadcasters to present both sides of controversial issues.[191] The fairness doctrine was premised on the "scarcity" of broadcast frequencies at the time.[192] This "scarcity rationale" has been "criticized … since its inception."[193] Abridging First Amendment rights based on the scarcity of frequencies rests on "a distinction without a difference;"[194] "makes no sense" in light of technological developments;[195] and "lacks any textual basis in the Constitution."[196]

Many government entities over the years have attempted to expand the fairness doctrine to contexts other than over-the-air broadcasting, but the Supreme Court has consistently rejected those requests.[197] As the Court explained, the "special justifications for regulation of the broadcast media" are simply "not applicable to other speakers."[198]

The First Amendment would not tolerate the Commission's attempt to impose a "fairness doctrine" for proxy advice because "the rationale for applying a less rigorous standard of First Amendment scrutiny to broadcast regulation, whatever its validity in the cases elaborating it, does not apply in [this] context."[199] No "scarcity" problem exists here, because there is "no requirement to buy [proxy advisers'] services; [investors] can buy from one, all, or none."[200] Thus, unlike regulations of broadcasters, regulations of proxy advisers are subject to the "settled principles of

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[191] *Red Lion Broad. Co. v. FCC*, 395 U.S. 367, 369 (1969).

[192] *Id.* at 390.

[193] *Turner Broad.* 512 U.S. at 638 & n.5.

[194] *Telecomm'ns Res. & Action Ctr. v. FCC*, 801 F.2d 501, 508 (D.C. Cir. 1986) (Bork, J.).

[195] *Action for Children's Television v. FCC*, 58 F.3d 654, 673 (D.C. Cir. 1995) (Edwards, C.J., dissenting).

[196] *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 532 (2009) (Thomas, J., concurring).

[197] *See, e.g.*, *Miami Herald*, 418 U.S. at 256-58 (print media); *Riley*, 487 U.S. at 795-98 (personal solicitation); *Pac. Gas*, 475 U.S. at 10 (mail); *Sable Comm'ns of Cal., Inc. v. FCC*, 492 U.S. 115, 127-28 (1989) (telephone); *Turner Broad.*, 512 U.S. at 637 (cable television); *Reno v. ACLU*, 521 U.S. 844, 867-70 (1997) (internet).

[198] *Reno*, 521 U.S. at 868.

[199] *Turner Broad.*, 512 U.S. at 637.

[200] Nell Minow, *Regulating Proxy Advisors Is Anticompetitive, Counterproductive, and Possibly Unconstitutional*, Harv. L. Sch. Forum on Corp. Governance & Fin. Reg. (Mar. 2, 2018), bit.ly/2tYfGMZ.

our First Amendment jurisprudence"—including "the fundamental rule of protection under the First Amendment, that a speaker has the autonomy to choose the content of his own message."[201]

Any attempt to defend proposed Rule 14a-2(b)(9)(iii) under the more lenient First Amendment standard of *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio* must also fail. The *Zauderer* standard, which applies to laws that require disclosures of "purely factual and uncontroversial information about the terms under which … services will be available,"[202] is confined to "'commercial speech'"[203]—*i.e.*, "'speech that does no more than propose a commercial transaction.'"[204] Because proxy advice "does much more than that,"[205] it is not the kind of purely commercial speech subject to *Zauderer*.[206] Nor is the proposed response provision under 14a-2(b)(9) limited to disclosures of "purely factual and uncontroversial information."[207] To the contrary, it requires proxy advisers to include within their speech issuers' *disagreements* with proxy advisers' research, analysis, and recommendations about how their clients should vote in upcoming shareholder votes. These disclosures are thus neither "factual" nor "uncontroversial." Even if the response provision were subject to the *Zauderer* standard rather than strict scrutiny, *Zauderer* could not justify a rule forcing a speaker to supplement its own speech with another party's contradictory opinions on sharply contested issues.

Finally, regardless of the level of scrutiny that applies here, the proposal to allow issuers to insert content into independent proxy advice would violate the First Amendment because "more benign and narrowly tailored options are available."[208] As explained at length elsewhere in these comments,[209] proxy advice is already regulated exhaustively under the Advisers Act, which imposes the highest fiduciary duties of care and loyalty on investment advice. The Commission

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[201] *Turner Broad.*, 512 U.S. at 639; *Hurley v. Irish-Am. Gay, Lesbian & Bisexual Grp. of Bos.*, 515 U.S. 557, 573 (1995).

[202] 471 U.S. 626, 651 (1985).

[203] *NIFLA*, 138 S. Ct. at 2372.

[204] *Harris v. Quinn*, 573 U.S. 616, 648 (2014).

[205] *Id.*

[206] *See NIFLA*, 138 S. Ct. at 2372; *Riley*, 487 U.S. at 796; *Pac. Gas*, 475 U.S. at 8-9.

[207] *Zauderer*, 471 U.S. at 651.

[208] *Riley*, 487 U.S. at 800.

[209] *Supra* at 21-23.

has not even tried to explain why robust enforcement of those requirements is insufficient to address any alleged concerns about the quality or accuracy of proxy advice without the need for coercive and burdensome restrictions on speech.

The Commission argues that its proposal is justified because it is "more efficient and timely" than other alternatives, such as having issuers communicate directly with shareholders if they disagree with a proxy adviser's analysis or recommendation.[210] But the Supreme Court has rejected an almost-identical argument even under intermediate scrutiny. As the Court explained in *McCullen v. Coakley*,[211] regardless of the level of scrutiny, there must be "a close fit between ends and means," and the government may not "too readily 'sacrific[e] speech for efficiency.'" The Commission's invocation of "efficiency" thus provides no basis for commandeering proxy advisers' speech. Supreme Court precedent is clear that the government may not "co-opt" a person's speech "to deliver [a] message" from someone else.[212] In sum, the Commission's "prophylactic, imprecise, and unduly burdensome rule … to reduce its alleged [investor] misperception,"[213] cannot survive tailoring analysis under any level of First Amendment scrutiny.

c. The review and feedback provisions of proposed Rule 14a-2(b)(9) also cannot satisfy any level of First Amendment scrutiny.

To facilitate issuers' and certain other parties' ability to rebut proxy advisers' speech, the Commission also proposes to impose not one, but two, issuer reviews—a draft review and feedback period and a final review opportunity—on the proxy advice process.[214] These requirements would force proxy advisers to delay giving their research and recommendations to their clients until the issuer and certain other types of solicitors can first review and provide feedback on the draft advice, and then for another two business days so they can review the final research report and voting advice. The Commission hopes that these extraordinary intrusions and delays will improve the "accuracy and soundness of the information and methodologies used

[210] PA Proposal at 53, 84 Fed. Reg. at 66533.

[211] 573 U.S. at 486.

[212] *NIFLA*, 138 S. Ct. at 2376; *see also Mills v. Alabama*, 384 U.S. 214, 219-20 (1966) (rejecting the state's complaint that "'as a practical matter, because of lack of time, [inaccurate statements] cannot be answered or their truth determined until after the election is over'").

[213] *Riley*, 487 U.S. at 800.

[214] PA Proposal at 44-53, 84 Fed. Reg. at 66530-33.

to formulate proxy [advisers'] recommendations"—or at least give companies and other covered solicitors enough time to prepare the response that the proxy adviser must include in its report.[215]

Like proposed Rule 14a-2(b)(9)(iii), the review and feedback provisions proposed to be added as 14a-2(b)(9)(ii) impose speaker-based, content-based, and viewpoint-based burdens on protected speech and association. This provision imposes unique burdens on one category of speech (proxy advice) and speakers (proxy advisers) based on the Commission's belief that this speech needs to be improved to public companies' (and the Commission's) satisfaction. Proposed 14a-2(b)(9)(ii) is thus a mechanism through which the Commission seeks to *alter the message and content* of one specific category of speech provided by one category of disfavored speakers. This is unquestionably a content-based restriction under cases such as *Reed*, *NIFLA*, and *Sorrell*.[216]

The review and feedback provisions would also unconstitutionally compel speech and association by forcing proxy advisers to share their confidential research reports, analysis, opinions, and recommendations with issuers and other covered solicitors *before they may share it with their own clients.* This information is typically kept confidential because it contains not only the proxy adviser's proprietary analysis and methodologies, but also the client's confidential information (in the case of client custom voting criteria or policies). Under the First Amendment, a person's decisions whether to speak and with whom are beyond the government's control.[217] And "'forced associations that burden protected speech are impermissible.'"[218]

Proposed Rule 14a-2(b)((9)(ii) is a paradigmatic example of compelled speech and association, as it would force a speaker to *share* confidential, sensitive, draft information with a third party while *withholding* that information from the parties with whom the speaker does wish to communicate. The Commission's proposal is no different analytically from a patently unconstitutional law requiring that all news stories be shown to the subject of those stories anywhere from 5-7 business days before publication to improve "accuracy" and facilitate "review and feedback."

The review and feedback provisions would severely burden proxy advisers' speech and association in other ways as well. By forcing advisers to submit their draft proxy research and

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[215] *Id.* at 11, 84 Fed. Reg. at 66520.

[216] *See supra* at 44 *et seq.*

[217] *Janus*, 138 S. Ct. at 2463.

[218] *Id.* (quoting *Pac. Gas*, 475 U.S. at 12).

recommendations for review by companies who are the subject of that research, this requirement "necessarily burdens [proxy advisers'] expression."[219] "[T]here can be little doubt that [proxy advisers] will feel compelled to respond to arguments and allegations made by [the companies]" and, thus, "alter [their] own message as a consequence of the government's coercive action."[220] "That kind of forced response is antithetical to the free discussion that the First Amendment seeks to foster."[221]

Even beyond this chilling compulsion for "feedback", the proposal would directly restrict proxy advisers' own speech and association. The proposed requirements would ban proxy advisers from releasing their research reports and recommendations to their clients for a set period of time—*i.e.*, until the issuer who is the subject of the research and voting recommendation first has the opportunity to review and critique the proxy adviser's draft report over either 3 or 5 business days, and then again until it has had a further two business days to review the finished report. But the First Amendment puts the decision of "when to speak" in the hands of the speaker, not the government.[222]

The burden on proxy advisers' First Amendment rights is further magnified by the fact that, under the proposal, proxy advisers would be forbidden to *change* or update their advice after the final review without starting the two-step review process all over again (which, of course, would be totally impracticable)—even to respond to the criticisms in the company's hyperlinked statement.[223] By "singl[ing] out [proxy advisers] and den[ying] them the right to address their chosen audience on matters of public importance," the proposed requirements are "'the purest example of a "law … abridging the freedom of speech."'"[224] Ironically, this would also lead to less accurate advice in cases where underlying facts changed during the lengthy and prescriptive process proposed. Proxy advisers would be at worst prohibited from, and at best hindered in, providing updates to their advice.

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[219] *Pac. Gas*, 475 U.S. at 15.

[220] *Id.* at 16.

[221] Id.

[222] *Telescope Media Grp. v. Lucero*, 936 F.3d 740, 747 (8th Cir. 2019); *see, e.g.*, *Mills,* 384 U.S. at 219 (invalidating law that prohibited electioneering on election day).

[223] PA Proposal at 48, 84 Fed. Reg. at 66531 n.121; *see Mills*, 384 U.S. at 220; *Ariz. Right to Life PAC v. Bayless*, 320 F.3d 1002, 1008-09 (9th Cir. 2003); *Catholic Leadership Coal. of Tex. v. Reisman*, 764 F.3d 409, 431 (5th Cir. 2014).

[224] *FCC v. League of Women Voters of Calif.*, 468 U.S. 364, 384 (1984).

The proposed review and feedback provisions fail any level of First Amendment scrutiny, as there are numerous less-restrictive alternatives that do not require the compulsion or suppression of speech. Issuers are free to communicate as much information as they would like to investors to urge them to support or oppose a certain proposal.[225] To the extent an issuer's analysis or recommendations diverge from the analysis or recommendations provided by a proxy adviser, the investor can review the competing information and decide for itself which recommendation and analysis to follow. The Supreme Court has rejected the "highly paternalistic notion" that the government should be deciding how information is presented to the public.[226] The First Amendment assumes "that people will perceive their own best interests if only they are well enough informed, and that the best means to that end is to open the channels of communication rather than to close them."[227] If issuers and the Commission dislike the content of proxy advisers' speech, the answer is more direct speech from issuers and the Commission, not a misguided attempt to manipulate the content or timing of proxy advisers' speech.

Moreover, as noted above, any purported concerns about the quality of proxy advice (although still unburdened by any reasonable proof or evidence) can be fully addressed through the Advisers Act's duties of care and loyalty without imposing a convoluted and burdensome preclearance requirement on proxy advisers' speech. Because these "more benign and narrowly tailored options are available," the Commission's "prophylactic, imprecise, and unduly burdensome rule … to reduce its alleged [investor] misperception" cannot survive scrutiny.[228]

d. The review, feedback and response provisions of the proposed rule amendments cannot be saved from unconstitutionality on the ground that they involve merely eligibility for an "exemption."

This rulemaking cannot be salvaged by the fact that proxy advisers are not *required* to claim exemptions under 14a-2(b)(1) and (b)(3). The Supreme Court "has made clear that even though a person has no 'right' to a valuable governmental benefit and even though the government may deny him the benefit for any number of reasons, there are some reasons upon which the government may not rely."[229] Most notably, the government "may not deny a benefit to

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[225] *See supra* at 41.

[226] Virginia Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 770 (1976).

[227] Id.

[228] *Riley*, 487 U.S. at 800.

[229] *Perry v. Sindermann*, 408 U.S. 593, 597 (1972).

person on a basis that infringes his constitutionally protected interests—especially, his interest in freedom of speech."[230] In other words, the government cannot withhold an otherwise available benefit in order to "produce a result which it could not command directly."[231]

Those principles squarely control here. For all the reasons set forth above, the First Amendment flatly prohibits the Commission from adopting Rule 14a-2(b)(9)(ii) and (iii). The Commission cannot circumvent that constitutional prohibition by depriving proxy advisers of a valuable exemption unless they "voluntarily" give up their First Amendment rights. In sum, nothing about the First Amendment defects with the proposal changes depending on whether the speech restrictions are set forth in a mandatory "rule" or as preconditions to obtaining an "exemption."

e. The review and feedback provisions violate the Takings Clause of the Fifth Amendment and interfere with proxy advisers' client relationships and legitimate reliance interests.

In addition to violating the First Amendment, proposed Rule 14a-2(b)(9)(ii) violates the Takings Clause and flouts proxy advisers' legitimate reliance interests in their longstanding advisory relationships with their clients. "A regulation" that "impedes the use of property" can be "so burdensome as to become a taking," even "without depriving the owner of all economically beneficial use."[232] The constitutional inquiry turns on "'a complex of factors,' including (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action."[233]

Those factors all point to a regulatory taking here. Proxy advisers like ISS have developed proprietary methods for researching, analyzing, and providing voting recommendations on a variety of proxy issues, and taking a variety of different approaches reflecting different investor requirements—methods that are implemented and revealed in their advice to clients.[234] This research and advice (and the proprietary information it contains) is normally subject to confidentiality agreements between the proxy adviser and its clients. The proposal, however, would force proxy advisers to share this valuable, proprietary, confidential information with the

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[230] *Id.*

[231] *Id.* (cleaned up).

[232] *Murr v. Wisconsin*, 137 S. Ct. 1933, 1943 (2017).

[233] *Id.* (quoting *Palazzolo v. Rhode Island*, 533 U.S. 606, 617 (2001)).

[234] *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1003 (1984) (holding that "trade secrets" and "other kinds of intangible interests" are "property for purposes of the Fifth Amendment's Taking Clause").

subject of the adviser's analysis. That company or other covered solicitor is not only outside the professional relationship between the proxy adviser and client, but, as the Commission recognizes, may *disagree* with the proxy adviser. The commenter thus has every incentive to attack and discredit its recommendations (especially when those recommendations differ from those of management).

The Takings concerns with this proposal are profound: The Commission would be ordering advisers to share confidential, proprietary information with potentially disagreeing (and sometimes hostile) third parties who are the subjects of the research and therefore inherently conflicted before sharing it with their own clients, thereby destroying the confidentiality of this information and interfering with the adviser-client relationship. The proposal also severely upsets proxy advisers' legitimate reliance interests.[235] If finalized, the proposal would undermine the independence of proxy advice by injecting interested third parties in between the adviser and its clients. In this way, the proposal would not only mandate the disclosure of sensitive and confidential information but could also undermine proxy advisers' independence and threaten their ability to offer neutral, disinterested and independent advice to their clients. Those provisions would harm proxy advisers' ability to compete and upend their longstanding reliance interests and investment-backed expectations.[236]

That the proposal would allow proxy advisers to insist that companies sign confidentiality agreements does not in any way alleviate these concerns. The confidentiality agreements would "cease to apply once the proxy [adviser] provides its advice to one or more recipients."[237] And, regardless, courts refuse to presume that confidentiality agreements will protect sensitive business information "when the person to whom the information is disclosed is involved in 'competitive decision-making.'"[238] Proxy advisers and companies are in that competitive position, as the Commission concedes. Thus, the risk that the proposed regulations will expose proxy advisers' proprietary, confidential information presents a grave risk of an unconstitutional taking and interferes with proxy advisers' legitimate reliance interests in their adviser-client relations.

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[235] *See*, *e.g.*, *Encino Motorcars v. Navarro*, 136 S. Ct. 2117, 2126-27 (2016) (holding that agency acted arbitrarily and capriciously in violation of the APA and was entitled to no deference where it failed to give due consideration to regulated industry's "serious reliance interests at stake").

[236] *See Philip Morris, Inc. v. Harshbarger*, 159 F.3d 670 (1st Cir. 1998).

[237] PA Proposal at 140, 84 Fed. Reg. at 66558. The proposal remarkably makes no provision for the subject of the advice to return or destroy the furnished draft and final proxy reports or to refrain from using them for the recipient's own purposes once the confidentiality agreement expires.

[238] *McAirlaids, Inc. v. Kimberly-Clark Corp.*, 299 F.R.D. 498, 500 (W.D. Va. 2014) (collecting cases).

f. At a minimum, the Exchange Act should not be construed to authorize the Commission's constitutionally defective proposed rule amendments.

At a minimum, the constitutional concerns about the proposed amendments to exemptions from the proxy rules for proxy voting advice are sufficiently serious that the Commission would not be deemed to have statutory authority to implement these regulations. For all the reasons set forth above, the best interpretation of the statute is that the Commission lacks *any* authority to regulate proxy advice as proxy solicitation.[239] But even if the Commission has some statutory authority in this area, any such authority would not extend to regulations that require compelled speech, the taking of valuable intellectual property, and the commandeering of proxy advisers' communications with their clients.

The judiciary "must rightly presume that Congress acts consistent with its duty to uphold the Constitution," and "courts must make every effort to construe statutes so as to find their constitutional foundations and thus avoid needless constitutional confrontations."[240] As the D.C. Circuit has explained, "[t]his canon of constitutional avoidance trumps *Chevron* deference, and we will not submit to an agency's interpretation of a statute if it 'presents serious constitutional difficulties[.]'[241]

The constitutional avoidance canon applies with full force here. Even assuming—contrary to the plain text of the statute—the Commission has some limited authority to regulate proxy advice as proxy solicitation, there is not the slightest indication in the relevant statutes that Congress intended to grant the agency authority to push the constitutional bounds of the First Amendment and Takings Clause by micromanaging proxy advisers' speech and destroying their valuable intellectual property.

3. The proposal upends almost ninety years of federal securities regulation.

In response to the "perception of many registrants" that "they lack an adequate opportunity to review proxy voting advice before it is disseminated" to shareholders, and that they "need" to "conduct a meaningful assessment of the advice and communicate any concerns or errors regarding the advice,"[242] the Commission proposes to force proxy advisers to give registrants and

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[239] See *supra* at 5-16.

[240] Nat'l Mining Ass'n v. Kempthorne, 512 F.3d 702, 711 (D.C. Cir. 2008) (quoting Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988); Ashwander v. Tenn. Valley Auth., 297 U.S. 288, 348 (1936) (Brandeis, J., concurring)).

[241] *Nat'l Mining Ass'n*, 512 F.3d at 711.

[242] PA Proposal at 39 and 52, 84 Fed. Reg. at 66529, 66533.

certain other parties two chances to review research and voting advice before it is disseminated to shareholders, along with mandatory opportunities to provide feedback and to insert a link to the affected party's assessment of that advice into the advice and any electronic medium used to deliver the advice.[243] In making this proposal, the SEC accepts without question the corporate community's contention that blatantly self-interested parties should have a say in the methodologies a proxy adviser employs and the opinions it conveys to the investors who are its clients. Despite the SEC's efforts to normalize this astounding thesis, it is anything but normal.

As Commissioner Peirce has recognized, Congress' decision 87 years ago to create a disclosure-based regime over a merit-based regime is "[o]ne of the foundational principles of our federal securities laws."[244] Thus, the Commission does not review securities offerings for fairness, conflicts of interest, or other merit-based elements, but requires issuers to make accurate disclosure of material information so offerings may be judged by investors.[245] Likewise, the Commission does not regulate the "substance of credit ratings or the procedures and methodologies by which any [registered credit rating agency] determines credit ratings,"[246] and there is no role for merit-based review under the Advisers Act. While the Commission does not propose to review the merits of proxy voting advice directly, it does propose to deputize registrants and certain other parties for that purpose, and to interpose them between advisers and their clients. In this respect, the proposal is without precedent.

The U.S. securities laws have never required a financial advisor to have its research, opinions and recommendations reviewed by the subjects of its advice, nor have the securities laws ever given the subjects of advice the right to provide "feedback" to the advisor. In fact, the opposite is true. As explained below, broker-dealers are forbidden by FINRA Rule 2241 to afford subject companies the right of prepublication review of analyst reports for any purpose other than verification of facts.[247] Before a draft report can be delivered to the subject company for a factual review, the research summary, research rating and price target must be removed, and a copy of the complete

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[243] Proposed Rule 14a-2(b)(9)(ii) and (iii). The first review would cover the proxy adviser's draft proxy advice, while the second would cover the final advice.

[244] Commissioner Hester S. Peirce, *Wolves and Wolverines: Remarks at the University of Michigan Law School* (September 24, 2018).

[245] See Commissioner Daniel M. Gallagher, *Remarks at Society of Corporate Secretaries & Governance Professionals* (July 11, 2013).

[246] Exchange Act, § 15E(c)(2),

[247] *See infra* at 65.

draft must be delivered to the firm's legal or compliance department. If the research department decides to change the proposed rating or price target after the subject company's review, the research department must provide written justification to, and receive written authorization from, legal or compliance personnel for the change.[248]

At the 2019 SEC Speaks program, the SEC's Investor Advocate noted the parallel between protecting the independence of sell-side recommendations and protecting the independence of proxy voting recommendations, saying:

> *Consider, for example, the rules currently in place for sell-side research, which generally aim to prevent issuers from influencing the research produced by investment firms. . . . I ask, why should the principle be any different when it comes to the independence of voting recommendations?"* [249]

Institutional investors who use proxy advisory services have said the same thing and have observed that allowing issuers to "police" proxy advisers would destroy the accuracy, independence and objectivity the institutions need to fulfill their own fiduciary responsibilities.[250]

The Commission's proposal to upend almost 90 years of federal securities regulation is a slippery slope to a dangerous place.

Imagine that three investment advisers—a proxy adviser, an adviser that furnishes non-discretionary investment advice, and a discretionary portfolio manager—all determine that the management of Company X is making bad decisions. The proxy adviser decides to recommend that its clients vote against the election of one or more of Company X's directors. The non-discretionary adviser decides to recommend that its clients refrain from buying shares of

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[248] Supplementary Material .05 to FINRA Rule 2241.

[249] Statement of Rick Fleming, SEC Investor Advocate (April 8, 2019) at note 18.

[250] 2018 T. Rowe Price Letter, *supra* note 146 at 3 ("We fail to see why the independence of sell side recommendations should be afforded greater protection than the independence of proxy recommendations"). *See also* letter from Paul Schott Stevens, President and CEO, Investment Company Institute to Vanessa Countryman, Acting Secretary, SEC (March 15, 2019) at 13 ("Fund advisers expect and must receive independent, objective, and accurate information from proxy advisory firms"); and letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, *et al.,* to Jeb Hensarling and Maxine Waters, Committee on Financial Services, Re: Proposed Legislation Relating to Proxy Advisory Firms, (November 9, 2017) at 3 ("Currently, proxy advisors provide equity holders of U.S. corporations with independent advice. [Proposed bills to regulate proxy advisory firms] threaten to abrogate that very independence, which is a hallmark of ownership and accountability").

Likewise, the Investment Adviser Association—a non-profit association with more than 650 federally-registered investment adviser members managing more than $25 trillion—recently characterized the Interpretation and Guidance and this rulemaking "not just as bad policy, but as a major step backwards for corporate governance and the independence of proxy advice." IAA Newsletter, Issue Number 325, January 2020 at 3.

Company X and sell the shares they already hold. The discretionary manager decides to rid its managed accounts of all Company X securities. If the management of Company X has the right to review and provide feedback on the proxy adviser's vote recommendations before they are made to investors, why should management not have the same rights in the case of the other advisers? What is to protect the non-discretionary manager from having to clear its research and investment recommendations through the company? What is to protect the discretionary manager from having to submit its investment committee's decisions to the company for review and feedback before it is allowed to trade its clients' portfolios? The Commission's differential treatment of these highly analogous scenarios would be a clear example of arbitrary decision-making if the proposed rules were finalized.

ISS urges the SEC to take a hard look at the implications of proposed Rule 14a-2(b)(9)(ii) and (iii) and to eliminate these sections from further consideration.

4. The proposal is inconsistent with proxy advisers' existing regulatory obligations.

Another problem with the proposal is that compliance with Rule 14a-2(b)(9)(ii) and (iii) would interfere with a proxy adviser's obligations under the Advisers Act and, where applicable, ERISA. As explained above, investment advisers have a fiduciary duty of loyalty which obliges them to act in their clients' best interests and not to put their own interests ahead of those of their clients. Subjecting a proxy adviser's methodologies, research and opinions to pre-release review and comment by the subjects of the advice introduces a new conflict of interest that would be challenging and costly to mitigate.

Although the Commission says that the proposal merely empowers registrants and certain other interested parties to "suggest revisions before the distribution of the advice" and does not require proxy advisers "to accept such suggested revisions," the Commission couples this statement with a warning that failure to accept "suggested revisions" could expose the proxy adviser to liability under Rule 14a-9.[251] This rule (about which, more below) prohibits materially misleading statements or omissions in proxy solicitations. While the rule historically has been used in cases of factual misstatements and omissions and not for disputes over honestly-held opinions, the Commission last year expressed the unprecedented view that "opinions, reasons, recommendations, or beliefs" can be "statements of material fact" actionable under Rule 14a-9.[252]

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[251] PA Proposal at 51, 84 Fed. Reg. 66532.

[252] Interpretation and Guidance, *supra* note 2 at 11, 84 Fed. Reg. at 47419.

Since the instant rulemaking is a thinly-veiled effort to give public companies control over proxy advice in order to quell shareholder dissent,[253] it does not take much imagination to connect the dots between a proxy adviser's rejection of a registrant's "suggested revisions" and 14a-9 litigation. Incentivizing advisers to skew their vote recommendations in management's favor in order to avoid the costs of defending baseless lawsuits contravenes the fiduciary principles that underpin the Advisers Act.

Not only would the proposal force proxy advisers to design new compliance procedures to evaluate "suggested revisions" to their benchmark, specialty and (presumably) custom[254] advice to somehow balance issuer dissatisfaction with their responsibilities to their investor clients, but the proposal would also force advisers to mitigate and disclose their own, new self-interest conflict in not getting sued for upsetting management or other interested parties.

In addition to interfering with proxy advisers' fiduciary responsibilities under the Advisers Act, the proposal also conflicts with advisers' obligation to implement reasonably effective insider trading compliance procedures.[255] Depending on the matter requiring shareholder action, a proxy vote recommendation might constitute material, nonpublic information ("MNPI"), the selective disclosure of which could diminish the fairness of the securities markets and harm investors. The SEC dismisses such concerns by pointing to a provision in the proposal that would allow proxy advisers to condition the selective release of their draft proxy research reports and vote recommendations on the recipients' agreeing to keep the materials confidential and to refrain from commenting on them until the advice has been provided to one or more of the adviser's clients. The SEC analogizes this situation to the use of confidentiality agreements to exempt the communication of MNPI from triggering the public disclosure requirements of Regulation FD.[256]

ISS does not share the Commission's confidence in this safeguard.

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[253] In this regard, we note that one of the loudest proponents of giving registrants review and feedback rights and the right to insert content into proxy advisory reports also urged the SEC to create a fiduciary safe harbor for any portfolio manager who either votes all proxies in favor of management or refrains from voting altogether. Letter from Neil A. Hansen, Vice President, Investor Relations and Corporate Secretary, ExxonMobil, to Vanessa Countryman, Secretary, SEC (July 26, 2019), available at https://www.sec.gov/comments/4-725/4725-5879063-188728.pdf ("ExxonMobil Letter").

[254] As indicated above, it is not clear whether the SEC intends to subject advice based on clients' custom proxy voting policies to the proposed rule revisions. *See supra* at 27-28.

[255] Advisers Act, § 204A, added by the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. Law 100-704, 102 Stat. 4677.

[256] PA Proposal at note 126 and accompanying text.

The distribution to management and certain dissident shareholders of multiple vote recommendations for each ballot item on each proxy for each public company in the United States will inevitably lead to the deliberate or accidental misuse of MNPI, regardless of any non-disclosure agreements. The Regulation FD safe harbor is not analogous to the proposal, because public companies are not compelled to selectively disclose confidential, market-moving information, but rather can assess the risks of disclosure on a case-by-case basis.

By contrast, proposed Rule 14a-2(b)(9)(ii) would force a proxy adviser to disclose MNPI to any issuer or covered dissident shareholder who signs a confidentiality agreement, even if that party is a known insider trader. Forcing disclosure in such cases would interfere with the adviser's obligation under the Advisers Act to establish, maintain and enforce policies and procedures reasonably designed to ensure compliance with the insider trading laws. It also would interfere with the adviser's duty to periodically test the sufficiency of its procedures and the effectiveness of their implementation, because even if the adviser determines that its pre-published proxy advice has been misused, it must continue to selectively disclose that information to the offending party(ies).[257]

The fact that ISS currently voluntarily provides certain issuers with a limited right to review the factual accuracy of data included in pending proxy research reports does not make the proposal any less objectionable. In order to protect the integrity of ISS' proxy advice and our singular focus on the best interests of our investor clients, the existing review process remains under the control of ISS and does not elicit feedback on ISS voting policies or the interpretation and application thereof.[258] Because substantially the same data are used to produce all ISS proxy voting reports, only benchmark reports, and not specialty or custom reports are available for pre-review, thereby further safeguarding the independence of our proxy advice, and enabling timely delivery of the research and recommendations to our clients.

ISS also takes steps to safeguard MNPI by not pre-releasing potentially market-moving draft reports and vote recommendations. In this regard, ISS allows selected issuers a limited review right of draft reports only for annual meetings, not special meetings. Furthermore, drafts are not provided for any annual meeting where the agenda includes a merger or acquisition

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[257] Advisers Act Rule 206(4)-7. The Commission does not say whether it expects proxy advisers to enforce their confidentiality agreements through litigation or otherwise, but if that is the expectation, the cost of such actions must also be factored into the Commission's economic analysis of this proposal.

[258] ISS does, however, invite issuer engagement during the formulation of annual proxy voting policies and guidelines. ISS' transparent policy development process includes a Policy Survey to identify issues that merit attention, as well as a notice and comment period designed to elicit feedback on the practical implementation of proposed policies.

proposal or proxy fight, or where it involves a situation that ISS, in its discretion, considers to be of a controversial or potentially market-moving nature, such as a "vote-no" campaign. ISS also makes it clear that any public release or redistribution of a draft analysis or the information contained therein may result in forfeiture of eligibility to review future draft reports. The proposal would mandate draft reviews in all such situations, raising significant concerns about confidentiality, selective disclosure of material non-public information, and the ability of proxy advice to be appropriately responsive to important and often fast-moving situations such as proxy fights and contested mergers and acquisitions.

5. The proposal is unworkable.

The proposed review, feedback and response-insertion provisions would impede proxy advisers' ability to deliver research and voting recommendations on U.S. corporations in a timely fashion. ISS estimates that the proposed review and feedback rights for registrants and certain other soliciting parties alone could reduce our report delivery time to our clients by between 45 and 65 percent. Getting confidentiality agreements in place with each registrant and other soliciting party who will have access to ISS' advice before it is transmitted to clients and arranging for active and appropriately co-ordinated hyperlinks where necessary will cause further delays. As a result, it is highly unlikely that ISS will be able to meet the high expectations of its clients to deliver research reports and vote recommendations to them sufficiently in advance of shareholder meetings to allow them ample time to review and consider our reports as they make their voting decisions. This would also reduce the time shareholders have to engage with companies after reviewing the research reports and before the meeting. These are both ironic results, given the importance the Commission places on having institutional investors carefully consider proxy advisers' recommendations before deciding to act on them.

6. Additional Comments on Proposed Rule 14a-2(b)(9)(i)

Without waiving or diminishing our challenge to the Commission's authority to regulate proxy advisers under Section 14(a), or any other argument made herein, ISS offers the following comments on certain questions the Commission has asked about its proposed adoption of Rule 14a-2(b)(9)(i):[259]

7. The text of proposed Rule 14a-2(b)(9)(i) is unnecessarily complicated and confusing. Material transactions and relationships described in subsection (B) are

[259] *Id.* at 35 *et seq*., 84 Fed. Reg. at 66527 - 66528.

subsumed in the direct or indirect material interests described in subsection (A). And both (A) and (B) can be folded into subsection (C) by eliminating the word "other" in the first line. As so revised, the provision would require disclosure of "Any information regarding the interest, transaction, or relationship of the proxy adviser (or its affiliates) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship."

ISS further urges the SEC to drop the use of the term "proxy voting advice businesses" and refer to these entities as "proxy advisers" or "proxy advisory firms" instead. There is no reason to create a new nomenclature when the marketplace already knows these entities by another name.

9. As explained above, the feedback we receive from many of our clients and that others have commented on is that most users of proxy advisory services believe that existing disclosures address all the concerns discussed in this release. The release does not identify any type of proxy adviser conflict that is not already being effectively disclosed.

10. Proxy advisers should be governed by a principles-based regulatory regime. For this reason, the Commission should not require such firms to disclose specific qualitative or quantitative information or impose prescriptive standards regarding the method of conflict disclosure. There is no reason to treat conflict disclosure by proxy advisers any differently from the way conflict disclosure by portfolio managers or any other type of investment adviser is treated. The guiding principle for all advisers should be "full and fair" disclosure, as that concept was described in the Fiduciary Standard Release:

> In order for disclosure to be full and fair, it should be sufficiently specific so that a client is able to understand the material fact or conflict of interest and make an informed decision whether to provide consent. . . .
>
> Whether the disclosure is full and fair will depend upon, among other things, the nature of the client, the scope of the services, and the material fact or conflict. Full and fair disclosure for an institutional client (including the specificity, level or detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications.[260]

11., 16. & 17. Another key reason to avoid overly prescriptive conflict disclosure requirements is to avoid interfering with proxy advisers' existing conflict management

[260] Fiduciary Standard Release, *supra* note 92 at 24-26, 84 Fed. Reg. at 33676-77.

policies and procedures. As explained above, ISS has implemented a comprehensive and robust set of conflict controls designed to meet the fiduciary standards of the Advisers Act. These controls include a firewall which would be compromised if conflict information were required to be publicly disclosed, or if disclosure were required to be displayed in or on a research report, instead of "around" the report as is currently the case. Proxy advisers do not need to embed their conflict disclosures or their conflict mitigation policies and procedures in their advice to make those disclosures full, fair and readily accessible to the users of our reports.

14. If the SEC adds subsection (b)(9) to Rule 14a-2, there is no reason to subject proxy advisers to the "significant relationship" disclosure requirement under subsection (b)(3)(ii). As explained above, the Commission adopted that exemption for financial advisors who provide voting advice to shareholders who have not asked for it, and not for proxy advisers, whom the SEC has characterized as fiduciaries. Introducing other random or disparate standards from the proxy rules or Regulation S-K would add nothing but confusion. The standard for identifying disclosable proxy adviser conflicts should simply be "materiality" — a standard both proxy advisers and their investor clients fully understand.

19. Registered proxy advisers are already obliged to make full and fair conflict disclosure in their ADV Forms which are publicly available through the SEC's Investment Adviser Public Disclosure ("IAPD") database. The SEC should not mandate public disclosure beyond that. Furthermore, many proxy advisers voluntarily post information about their conflict mitigation practices on their websites. In so doing, they are able to decide for themselves how best to safeguard their sensitive business information. Forcing advisers to publicly disclose granular information about product sales and revenue would be anti-competitive.

20. & 21. Registered proxy advisers are already required to make conflict disclosures to clients in response to designated questions in the Form ADV; to describe their Codes of Ethics and to offer copies of those Codes to clients and prospective clients upon request. There is no reason to subject advisers who furnish non-discretionary proxy research and vote recommendations to more stringent standards than those that apply to advisers who make buy/sell recommendations or advisers who exercise investment discretion over client assets.

22. As noted above, ISS believes that proposed subsection (b)(9)(i)(B) should be eliminated, because the principles-based language in subsection (b)(9)(i)(C) is sufficient to protect investors. ISS also strongly objects to the proposed requirement in (b)(9)(i)(B) that proxy advisers search publicly available information to identify possible affiliates of registrants, shareholder proponents and other "soliciting persons" to determine whether or not the adviser might have a relationship, or be engaged in a transaction, with such parties. If such a search uncovers a possible affiliation ISS was not otherwise aware of, there would be no benefit to offset the cost and delay because any such relationship could not have compromised the integrity of the proxy advice in the first place.

Furthermore, ISS does not support the imposition of mandatory structural "reforms." While ISS already has separated its proxy research/analysis activities from its other business lines, this type of separation might not be feasible or appropriate for all proxy advisory firms. Proxy advisers come in many shapes and sizes and a one-size-fits-all approach would have a negative effect on competition and on investor choice.

Finally, ISS cannot help but note the irony of the proposal's reference to the global analyst research settlements.[261] These settlements resulted from a series of turn-of-the century scandals involving conflicted reports by research analysts at investment banks. In addition to structural reforms, the settling defendants agreed to make independent research available to their customers for a period of five years. Apart from the settlement, the Commission approved a package of self-regulatory organization rules (now consolidated in FINRA Rule 2241) in order to "restore investor confidence in the analysts' work" by requiring independence in research and recommendations.[262] In this regard, Rule 2241 requires FINRA members to establish, maintain and enforce written policies and procedures designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports. Such policies and procedures must, among other things, "*prohibit* prepublication review of a research report by the subject company for purposes other than verification of facts."[263]

The proposal to *mandate* prepublication review by the subject companies not just of

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[261] PA Proposal at 38, n. 92 and accompanying text, 84 Fed. Reg. at 66528.

[262] Lori Richards, Director, Office of Compliance Inspections & Examinations, SEC, Speech by SEC Staff: Analysts Conflicts of Interest—Taking Steps to Remove Bias (May 8, 2002); *See also* Order Approving Proposed Rule Changes by the NASD and NYSE, Exchange Act Release No. 45908, 67 Fed. Reg. 34968 (May 15, 2002).

[263] FINRA Rule 2241(b)(2)(N) (emphasis supplied).

facts, but also of the research, analysis, opinions and recommendations in all proxy research reports, and to afford such companies the right to insert their own content into the proxy reports would put the provision of "independent research" to the proxy advice marketplace significantly at risk, because every proxy advisory report would carry an issuer taint.

23. Proxy voting advice is a form of investment advice. A proxy adviser is a type of investment adviser. Investment advisers are regulated under the Advisers Act, a regime that addresses the identification, management and disclosure of conflicts of interest. Consequently, the SEC should regulate all proxy advisers under the Advisers Act in lieu of adopting proposed Rule 14a-2(b)(9)(i). Doing so would align proxy advisers' duties with the duties that their investment adviser clients owe to their own clients, thus providing the ultimate investors and their beneficiaries with two layers of fiduciary protection.

7. Additional Comments on Proposed Rules 14a-2(b)(9)(ii) and (iii)

Without waiving or diminishing our challenge to the Commission's authority to regulate proxy advisers under Section 14(a), or any other argument made herein, ISS offers the following additional comments on certain questions the Commission has asked about its proposed adoption of Rule 14a-2(b)(9)(ii) and (iii).[264]

25. Because there are no legitimate concerns about investors' ability to get accurate and complete proxy voting advice, there is no justification for adding the proposed conditions to the exemptions in Rules 14a-2(b)(1) and 14a-2(b)(3).

29. Tinkering with the details of this proposal cannot rehabilitate it. Allowing an inherently self-interested party to have a say in a proxy adviser's opinions about that party is insupportable, regardless of any ancillary disclosure about the details of the intrusion.

31. Neither proxy advisers nor their shareholder clients should be expected to pay for issuers' intrusion into their relationship. Having issuers pay for the privilege of influencing proxy advice would make the intrusion all the more dangerous. The best way to protect investors is to remove the intrusion altogether.

[264] PA Proposal at 60 *et seq.*, 84 Fed. Reg. at 66535 *et seq.*

32. Congress enacted Exchange Act Section 14(a) to control unfair practices by corporate insiders.[265] Using this provision to give issuers an inappropriate and inherently conflicted role in the production of proxy advice, while denying the same rights to shareholder proponents and persons engaged in exempt solicitations flips the congressional intent behind this provision on its head. But to be clear, ISS does not believe that any of these parties should have a mandated say in the methodologies ISS uses or the research and opinions it renders to its clients.

33. It is even more inappropriate to give issuers or other interested parties the right to review, comment on and insert content into proxy advice based on clients' own proprietary custom guidelines.[266]

36. If the Commission insists on pursuing rulemaking in this area, ISS urges the Commission to harmonize the issuer pre-release review provisions with the equity analyst review provisions found FINRA Rule 2241, and with existing requirements under the Advisers Act. For the Commission's convenience, we offer the following suggestion:

1. *Proxy Advisory Research Reports; Identifying and Managing Conflicts of Interest*

   (a) A proxy advisory firm must establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage and disclose conflicts of interest related to the interaction between research analysts and those outside of the research department, including subject companies or other interested parties.

   (b) A proxy advisory firm's written policies and procedures must be reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and the rendering of proxy voting advice that is in the best interests of the proxy advisory firm's clients. Such policies and procedures must prohibit prepublication review of a proxy voting research report by a subject company or other interested party for purposes other than verification of facts.

2. *Submission of Sections of a Draft Research Reports for Factual Review*

   Consistent with the requirements of paragraph 1.(b) above, sections of a draft research report may be, but are not required to be, provided to the subject company or other interested party for factual review so long as:

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[265] *See supra* at 8-9.

[266] *See supra* at 27-28.

(a) the sections of the report submitted do not contain the vote recommendation, or substantive analysis affecting the recommendation;

(b) a complete draft of the report is provided to legal or compliance personnel before sections of the report are submitted to the subject company or other interested party; and

(c) if, after submitting sections of the report to the subject company, the research department intends to change the proposed vote recommendation, it must first provide written justification to, and receive written authorization from a senior analyst, or legal or compliance personnel for the change. The proxy adviser must retain copies of any pre-reviewed draft and the final version of such report for five years after publication.

39. Although confidentiality agreements may be of limited utility in the case of compulsory disclosure, proxy advisers nevertheless should be allowed to require them as a condition to giving interested parties an advance look at proxy advice. However, requiring the terms of a confidentiality agreement with a registrant or other interested party to be no more restrictive than those of similar types of confidentiality agreements the proxy adviser uses with its clients, is unworkable, because ISS does not selectively disclose its pre-published reports and recommendations to clients. The confidentiality arrangements ISS has with its clients are for a different purpose and not a suitable model for the pre-release of MNPI to the subjects of the proxy advice.

40. As explained above, it is constitutionally impermissible to compel proxy advisers to link their advice to contrary (or any) statements by registrants or other interested parties.

43. If this rulemaking does move forward, the Commission should codify the view that a proxy adviser is not liable for the content of a registrant's or other soliciting party's statement hyperlinked or otherwise inserted into proxy advice. The Commission also should affirm that a proxy adviser will not be liable if the recipient of pre-publication proxy advice misuses MNPI contained therein. Proxy advisers who are compelled to release drafts of their advice should not be responsible for enforcing confidentiality agreements with the recipients of those drafts. The moral hazard here lies squarely on the Commission's shoulders.

44. The Commission should not require proxy advisers to disable automated features of their voting platforms in instances where a registrant has

responded to voting advice or otherwise. This is another bad idea from a vocal corporation seeking to stifle shareholder dissent.[267] The principles-based regulatory regime established under the Advisers Act is flexible enough to enforce investment advisers' fiduciary duties even in a fully automated environment.[268] The Commission should not micromanage institutional investors' operations or dictate the tools and services they use in serving their clients.

46. & 48. Likewise, the Commission should refrain from micromanaging the interactions between proxy advisers and registrants or other covered soliciting parties. Proxy advisers should have the flexibility to determine the best way to manage any engagement with, or review of information by, issuers—if at all—while satisfying their fiduciary duties to their clients.

47. As discussed below, implementation of the proposed rules would require significant changes to the systems and processes currently used to prepare and deliver proxy research reports and voting recommendations.[269] For several reasons, the current draft review process which ISS has voluntarily implemented is not an appropriate or relevant benchmark for assessing the potential impact of the fundamentally different regime that would be required under the rulemaking. In addition to the unprecedented two-step issuer review process, a key distinguishing factor is the sheer increase in the number of proxy research reports which would be eligible for the pre-review rights. Administering this vastly expanded and prescriptive process would necessitate increased personnel and technology enhancements. This would include everything from the new work associated with identifying and communicating with eligible issuers, negotiating and implementing confidentiality agreements, tracking and processing the multiple rounds of issuer feedback which would vary based on issuer filing dates, and facilitating the hyperlinks to issuers' statements in response to a proxy advisors proxy research reports.

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[267] ExxonMobil Letter, *supra* note 253 at 21.

[268] Fiduciary Standard Release, *supra* note 92 at note 27, citing Division of Investment Management, "Robo-Advisers," IM Guidance Update No. 2017-02 (February 2017), available at https://www.sec.gov/investment/im-guidance-2017-02.pdf.

[269] *See infra* at 76-77.

49. - 51. These questions assume facts not in evidence. There is no credible evidence of factual errors or methodological weaknesses in proxy advisers' research and advice.

C. The Liability Component; Proposed Changes to Rule 14a-9

The SEC further proposes to amend Rule 14a-9 to include examples of information that, if omitted from proxy advice, could serve as the basis of anti-fraud claims against the proxy adviser. Such information would include: the proxy adviser's methodology, sources of information, conflicts of interest or use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.[270] This obligation presumably would apply even where the methodologies and standards the proxy adviser uses in formulating its advice are dictated by its investor clients on a proprietary, custom basis.

The Commission bases this part of the proposal on the very shaky foundation of the Interpretation and Guidance which, in an unprecedented bending of the plain meaning of "fact," indicated that a proxy adviser could be sued for its "opinions, reasons, recommendations, or beliefs."[271] In staking out this novel position, the Commission sought support from cases that are factually inapposite to the circumstances around proxy advisory firms. For example, the Commission cited *Virginia Bankshares v. Sandberg,*[272] but in that case, the court confined its discussion to statements of belief and opinion that corporate directors made about a recommended course of action, knowing they did not hold the beliefs and opinions they expressed. Courts applying *Virginia Bankshares* have said, "While material statements of fact are false if they are contradicted by true facts, material statements of opinion are false only if the opinion was not sincerely held."[273] Other courts have held that "quibbles" with the methodology used in a fairness opinion summarized in a proxy statement "cannot be the basis of a disclosure claim."[274]

Moreover, the First Amendment prohibits any rule that would impose liability based on an adviser's "opinions," "beliefs," or "recommendations," including an adviser's decision to use

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[270] *See* proposed note (e) to Rule 14a-9.

[271] *See supra,* note 252.

[272] 501 U.S. 1083, 1090, 115 L.Ed. 2d 929, 944, 111 S. Ct. 2749, 2757 (1991).

[273] *Bond Opportunity Fund v. Unilab Corp.,* 2003 U.S. Dist. LEXIS 7838 (S.D.N.Y. 2003) at *16, *quoting In re McKesson HBOC, Inc. Securities Litigation,* 128 F. Supp. 2d 1248, 1265 (N.D. Cal. 2000).

[274] *Ridler v. Hutchinson Tech., Inc.,* 216 F. Supp. 3d 982, 989 (D. Minn. 2016) *quoting In re 3Com,* 2009 Del. Ch. LEXIS 215 (2009) at *6.

standards different from the ones set or approved by the SEC. By definition, an opinion or recommendation cannot be proven true or false. Courts have thus consistently rejected attempts to impose liability on speakers for non-factual statements of opinion or belief.[275] A speaker's opinion, belief, or recommendation is at the very core of protected expression and cannot, consistent with the First Amendment, be subject to liability on the ground that it is somehow inaccurate or incomplete.

Undeterred by the dearth of legal support for its new interpretation or the serious constitutional concerns it entails, the Commission now proposes to use the litigation hammer of Rule 14a-9 to allay concerns expressed by the corporate community that they may be judged by anything other than the minimum corporate governance standards allowed by law. The examples the SEC cites – director independence and the frequency of shareholder votes on executive compensation-- are at the top of registrants' list of pet peeves regarding shareholders and the parties who advise them. [276]

On the other hand, the SEC does not suggest that the clients of proxy advisory services have asked for this change, which is not surprising. As explained above, these investors already receive extensive information about proxy advisers' conflicts of interest, and the information and methodologies they use in formulating their advice. [277] This is certainly the case for clients of ISS. Indeed, because the consumers of proxy advice either design or select the methodologies that underlie that advice, it is they who decide whether the companies they own should be held to higher standards and requirements than the ones set or approved by the SEC. Finally, investors who engage proxy advisory services are fully protected by the anti-fraud provision of the Advisers Act, which applies to all proxy advisers whether they are registered with the SEC or not.[278]

The Commission itself admits that proxy advisers may already be making the kinds of disclosures covered by proposed note (e) to Rule 14a-9,[279] which is yet another factor that calls the

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[275] *See*, *e.g.*, *Hustler Magazine v. Falwell*, 485 U.S. 46, 57 (1988) (speech could not be actionable because it could not "reasonably be understood as describing actual facts"); *Leidholt v. L.F.P., Inc.*, 860 F.2d 894 (9th Cir. 1988) (article not actionable where it "telegraph[ed] to the reader that the article presents opinions, not allegations of fact"); *Jewell v. NYP Holdings*, 23 F. Supp. 2d 348 (S.D.N.Y. 1998);

[276] PA Proposal at note 160. *See also* Interpretation and Guidance *supra* note 2 at note 34, suggesting that in order to avoid liability under Rule 14a-9 a proxy adviser might have to explain why the peer group the adviser uses in assessing executive compensation proposals differs from the one selected by the registrant. Peer group selection is another sore point with the corporate community.

[277] *See supra* at 22.

[278] *Supra* note 98 and accompanying text.

[279] PA Proposal at note 166.

need for this rulemaking into question. Although the Commission confirms that proxy advisers and their clients "may use any standards or criteria for proxy voting advice" they choose,[280] the proposed amendment of Rule 14a-9 appears designed to have an *in terrorem* effect, the ultimate goal of which is to free public companies from even minor dissenting views, thereby hindering effective shareholder oversight.

ISS urges the Commission to withdraw this part of the proposal.

- **Additional Comments on Proposed Changes to Rule 14a-9**

Without waiving or diminishing our challenge to the Commission's authority to regulate proxy advisers under Section 14(a), or any other argument made herein, ISS offers the following comments on certain questions the Commission has asked about its proposed adoption of Rule 14a-9.[281]

> 54. If the Commission believes that shareholders have the right to decide which standards or criteria to apply to their proxy voting decisions, the Commission should refrain from erecting obstacles to their decision-making process. This means, among other things, that they and their fiduciary proxy advisers should not be constrained by standards or requirements set or approved by the SEC or any other legal or regulatory body.
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> 55. There is no justification for adding additional "standards or criteria" disclosure requirements to Rule 14a-2(b)(9), because adequate disclosure is already mandated by, and being provided under, the Advisers Act.

D. The Economic Analysis

Although the Commission appends a lengthy economic analysis to its proposal, this discussion only further confirms the deficiencies with this regulatory endeavor.

1. The economic analysis uses the wrong baseline.

The Commission cites "current regulatory requirements" applicable to proxy advisers, their clients and issuers and "current industry practices" as forming the baseline against which benefits, costs and other economic impacts of the proposal are to be measured.[282] However, the "current

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[280] *Id.* at 72, 84 Fed. Reg. at 66539.

[281] PA Proposal at 73, 84 Fed. Reg. at 66539.

[282] PA Proposal at 83, 84 Fed. Reg. at 66542.

regulatory requirements" the Commission identifies for proxy advisers are the ones articulated in the Interpretation and Guidance which the Commission adopted without the benefit of public comment or any economic analysis whatsoever.[283] As explained above, prior to the adoption of the Interpretation and Guidance in August 2019, proxy voting advice rendered in the course of a fiduciary relationship was governed exclusively by the Advisers Act. The only voting advice governed by the proxy rules at that time was advice voluntarily supplied to persons who did not ask for it.[284] ISS submits, therefore, that the economic consequences of this proposal should be judged against the requirements and industry practices that exist under the Advisers Act, not the post-August 2019 version of the Exchange Act proxy rules.

2. The benefits of the proposed rule amendments are illusory at best.

The Commission opines that the proposed amendment to the definition of "solicitation" in Rule 14a-1(*l*) may benefit proxy advisers and their clients by codifying the definition the Commission adopted in the Interpretation and Guidance.[285] ISS assures the Commission that having its fiduciary activities subjected to a regulatory regime that was created to protect investors from "unscrupulous corporate officials" and "irresponsible outsiders" seeking to retain or wrest control of a corporation is no benefit at all.[286] This is especially so since the whole purpose of redefining "solicitation" apparently is to subject proxy advisers' independent research, analyses, recommendations and opinions to editorial oversight by issuers and other self-interested parties, under a threat of litigation. For their part, many investors who are proxy advisers' clients have made it clear that they do not see any benefits—only risks and downside— in the interposition of the subjects of proxy advice into the fiduciary relationship between the clients and their proxy advisers.[287]

The Commission next describes the proposed amendment of Rule 14a-2(b) regarding conflict of interest disclosures as an enhancement of existing requirements that could benefit proxy advisers' clients by enabling them to better judge the objectivity of proxy advice.[288] This

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[283] *Id.* at 85, 98, 103, 104, 109, 84 Fed. Reg. at 66542-66543, 66546, 66548, 66549 .

[284] *Supra* at 12-13.

[285] PA Proposal at 98, 84 Fed. Reg. at 66546.

[286] *Supra* at 9.

[287] *Id.* at note 250.

[288] PA Proposal at 98 - 99, 84 Fed. Reg. at 66546.

faulty assessment illustrates the importance of selecting the correct baseline for the economic analysis of this rulemaking, because while proposed Rule 14a-2(b)(9)(i) may enhance the existing requirements under the proxy rules, judged by the fiduciary standards of the Advisers Act, it is no enhancement at all.

Furthermore, while the Commission acknowledges that "some" proxy advisers have "asserted" that they have conflict of interest practices and procedures,[289] and that proxy advisers "may already provide conflicts disclosure" to their investment adviser clients,[290] the Commission grossly understates the evidence on this issue. Proxy advisers' existing disclosures in their Forms ADV and their websites, along with the transcript from the 2018 Roundtable on the Proxy Process leave no room for doubt that proxy advisers currently provide information that meets or exceeds the information covered by 14a-2(b)(9)(i).[291] The benefits of this proposal are not just "limited," as the Commission admits;[292] they are non-existent.

The same can be said for the purported benefits to be derived from the proposed review, feedback and response provisions. The SEC suggests that these provisions would benefit proxy advisers' clients by "enhancing the overall mix of information" available to them as they make their voting decisions.[293] However, if that really were the intent of this rulemaking, shareholders and others with dissenting views would be given an equal opportunity to review, provide feedback on and insert responses into proxy statements and other communications circulated by or on behalf of issuers.

The Commission also theorizes that the consumers of proxy advice could benefit if proxy advisers alter their advice in response to issuers' and other soliciting parties' feedback because such altered advice could be "more accurate and complete."[294] The SEC does not address the fact that accurate and complete advice is already provided to the general satisfaction of the clients of proxy advisers. Nor does the SEC address the possibility that the feedback from such self-

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[289] *Id.* at 100, 84 Fed. Reg. at 66547.

[290] *Id.* at 105, 84 Fed. Reg. at 66548.

[291] *Supra* at 36. ISS questions the use of the word "may" in discussing current conflict of interest disclosure practices in light of the SEC's recent instruction that that word should not be used to describe a situation that already exists. Fiduciary Standard Release, *supra* note 92 at 25, 84 Fed. Reg. at 33676.

[292] PA Proposal at 100, 84 Fed. Reg. at 66547.

[293] *Id.* at 101, 84 Fed. Reg. at 66547.

[294] Id.

interested parties might be inaccurate or even fraudulent, or that the alteration of draft proxy advice to err on the "safe side" in complex or contentious situations might just be a response to a threat of costly litigation.

Moreover, the SEC does not even try to reconcile its estimation of the benefits of Rule 14a-2(b)(9)(ii) and (iii) with the very clear statements by investors and their legitimate representatives that they do not want their proxy advice filtered through the subject of that advice.[295] Issuers and other soliciting parties already have effective channels to communicate with shareholders.[296] It is independent thought that investors seek from their proxy advisers.

The real beneficiaries of the proposed review, feedback and response provisions would be many self-interested corporate insiders, who, after decades of trying, will finally have a "role to play" in vetting the sources of independent information shareholders use in making their proxy voting decisions.[297] The subjects of proxy voting advice are also the only ones who stand to benefit from the proposed change to Rule 14a-9, because that change will codify the Interpretation and Guidance's unprecedented and unconstitutional view that proxy advisers can be sued for their "opinions, reasons, recommendations or beliefs." Moreover, by forcing granular disclosure of any standards or requirements that materially differ from ones the SEC sets or approves, the proposal also incentivizes proxy advisers and shareholders to hold companies accountable only to the lowest standards and requirements mandated by law.

Like the rest of the proposal, the proposed amendment of Rule 14a-9 would not confer any benefit on the investors who are clients of proxy advisers, for they are already protected by the anti-fraud provision of the Advisers Act.[298] And because it is they who create or otherwise select the standards and requirements proxy advisers use in the formulation of voting advice, clients would derive no benefit from duplicative disclosure of those standards. Finally, from the proxy advisers' perspective, the proposed amendment of Rule 14a-9 is nothing more than an SEC-sanctioned weapon bestowed on the issuers who are subjects of proxy advice, to deter the issuance of any views, opinions or vote recommendations that might deviate from those of corporate management.

None of the benefits the Commission has identified justifies this rulemaking.

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[295] *See supra* at 25-26, 58.

[296] *Id.* at 41-42.

[297] *Id.* at 42.

[298] *Id.* at 21.

3. The costs of the proposal on proxy advisers have been grossly underestimated.

The Commission candidly concedes that it lacks the data necessary to quantify many of the costs associated with its proposal.[299] Given the fact that the proposal would not confer any benefits whatsoever on investors or proxy advisers, it is not necessary to calculate the costs with precision in order to conclude that the proposal is not economically justified. Nevertheless, ISS offers the following thoughts on the real costs that the proposal has failed properly to consider.

a. The costs of satisfying the review, feedback and response provisions

During calendar year 2019, ISS voluntarily provided approximately 450 draft reports to issuers in the United States for one round of fact-checking. ISS estimates that the number of reports potentially required under proposed Rule 14a-2(b)(9)(ii) could range from approximately 6,500 to close to 25,000.[300] Those extraordinary numbers would be even higher by an extreme magnitude if custom reports were also included. Either way, ISS would incur substantial administrative costs just to track two rounds of distribution and resulting feedback for this large volume of reports. It is completely inappropriate and off-base to suggest that the current draft review process—that ISS voluntarily implemented and for which ISS has established parameters and controls—can somehow be scaled to meet the comprehensive new requirements outlined in the proposed rule.

ISS would also incur substantial costs, including legal expenses, in creating, negotiating and implementing at least 6,000 confidentiality agreements with registrants and other soliciting parties.[301]

In addition to the 5 to 7 *business* days proposed to be given to issuers under Rule 14a-2(b)(9)(ii) (which could represent as many as 11 *calendar* days, depending when weekends fall in the process), ISS estimates that it would take an average of 2-3 additional ISS analyst working days per report for our research production team to thoroughly ingest, review, validate and address feedback on each report. Because feedback would now cover not just factual accuracy, but also methodology, opinions and judgments, with the threat of legal liability hanging over the

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[299] PA Proposal at 105-109, 84 Fed. Reg. at 66548-49.

[300] In the case of ISS, including specialty draft reports in the proposed review and feedback provisions would expand the total number of reports covered by the new requirements by up to a factor of 5 per company.

[301] Because ISS does not currently pre-release reports containing material, non-public information, ISS does not have such agreements in place.

process, an unknowable number of feedback reviews would involve ISS' legal and compliance teams, and possibly outside counsel, in order to safeguard the independence and integrity of our fiduciary advice, while at the same time protecting ourselves against the threat of litigation under Rule 14a-9. Registrants or other solicitors who are not satisfied with ISS' final proxy advice could force ISS to incur additional research, administrative, compliance and IT expenses related to the insertion of a link to their response in our reports, for which we would have no right of reply.

As noted above, the delays created by the review and feedback provisions in an already compressed time period could seriously impede ISS' ability to meet its contractual commitments to clients.[302] While the Commission acknowledges that proxy advisers may incur costs in renegotiating client contracts,[303] the Commission does not also acknowledge the possibility that clients will terminate their contracts altogether if they find their diminished review period unacceptable.[304]

On the other hand, the Commission does acknowledge that the review, feedback and response provisions may dissuade clients from using proxy advisory services because of concerns regarding the objectivity and integrity of advice that has been vetted by its subjects. The Commission leaves it to the proxy advisers to find a way to deal with this problem, without acknowledging either the substantial costs involved or the inappropriate nature of that potential outcome, which would be directly contrary to the stated objectives of the proposal.

b. The costs of amending existing compliance programs

As reflected throughout these comments, the Commission's proposal would interfere with proxy advisers' existing obligations under the Advisers Act and, possibly, ERISA. The proposed amendments would require ISS to amend its compliance program in at least the following respects:

- Embedding conflict disclosures in the proxy reports, as currently proposed in Rule 14a-2(b)(9)(i), would compromise the firewall ISS has erected between its proxy advisory service and its corporate services subsidiary.[305] ISS has gone to great expense in creating this safeguard and would incur substantial costs in developing an alternative.

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[302] *Supra* at 62.

[303] PA Proposal at 107, 84 Fed. Reg. at 66549.

[304] If the Commission intends to include reports based on clients' custom guidelines in the review, feedback and response provisions, ISS will also be required to renegotiate its confidentiality agreements with the clients who utilize such guidelines. These clients also may choose to terminate their agreements rather than have their private information disclosed to issuers and other soliciting parties.

[305] *Supra* at 32.

- Giving the subjects of ISS' proxy advice the ability to vet the methodologies, opinions, and judgments reflected in that advice would create a substantial new conflict of interest that ISS would have to expend substantial resources to manage and disclose.

- Subjecting proxy advisers to litigation risk under Rule 14a-9 for their "opinions, reasons, recommendations and beliefs" could potentially incentivize proxy advisers to alter their advice in accordance with the feedback they receive from the subjects of that advice. This creates another new conflict of interest that ISS would have to expend resources to manage and disclose.

- The disclosure of draft proxy reports containing MNPI would require changes to ISS' existing insider trading procedures. It is unclear how ISS would satisfy its duty to enforce a new procedure in this regard, since the proposal does not permit a proxy adviser to withhold MNPI from any registrant or other solicitor who has signed a confidentiality agreement, even if that party is a known insider trader.

- Every change to ISS' compliance program would necessitate additional training, documentation, and ongoing testing, all of which would further increase ISS' costs.

- The Commission's assertion that,"[t]here is no specified retention period for any information maintained, disclosed or provided pursuant to the proposed amendments" is inaccurate.[306] Advisers Act Rule 204-2 would require ISS and other proxy advisers to maintain, at a minimum, the following records for a period of five years: (i) the new confidentiality agreements, (ii) communications with issuers or other covered solicitors about proxy advice, (iii) new compliance procedures, training thereon and testing thereof, and (iv) disclosures to clients.

c. Litigation costs

The Commission's aggressive interpretation of Rule 14a-9, coupled with the review and feedback provisions, substantially increases the litigation risk of any proxy adviser that refuses to compromise the independence of its advice. While it is impossible to put a dollar figure on insuring against this risk, ISS is disappointed that the Commission ignores this cost altogether.[307]

4. The costs of the proposal on consumers of proxy advice have been grossly underestimated.

As the Commission acknowledges, some or all of the costs this proposal would impose on proxy advisers may be passed through to the investors who use their services.[308] Those

[306] PA Proposal at 122, 84 Fed. Reg. at 66553.

[307] *Id.* at 109, 84 Fed. Reg. at 66549.

[308] *Id.* at 108, 84 Fed. Reg. at 66549.

investors also are likely to be burdened by the fact that the time they currently have to review proxy research reports and recommendations and to make their voting decisions will be reduced, with time instead diverted to give two rounds of review to the subjects of the advice. While hard to quantify in dollars, the cost of lost time may be the greatest cost imposed on consumers by this proposal, severely compressing the time that investors have to process and use proxy research reports, to engage with the companies in which they are invested, and to thoughtfully exercise their proxy voting responsibilities.

These costs, while significant, pale in comparison with the possible loss of diverse thought in the marketplace for proxy advice. As it stands today, each proxy adviser is free to analyze corporate governance and other voting matters in accordance with methodologies and criteria of its and its clients' choosing. So long as these methodologies and criteria are properly disclosed, clients themselves can assess whether they are appropriate for their own goals and objectives. Forcing every U.S. proxy adviser to vet their methodologies, criteria, opinions and judgments through the subjects of their advice—under threat of litigation—could diminish proxy advisers' willingness to recommend votes against management or other soliciting parties, or to stray too far from corporate managements' points of view. This would substantially diminish the independent information available to shareholders, as well as their ability to hold management of public companies accountable for their actions.

5. The proposal's burdens on the U.S. capital markets have been grossly underestimated.

Using the proxy rules to try to keep proxy advisers from voicing opinions not acceptable to management, and reducing the availability and timeliness of independent research and advice that helps investors carry out their fiduciary duties has implications beyond any individual shareholder or ballot proposal. Silencing dissenting views on corporate governance matters like executive compensation, board independence, *etc.* would likely lead to the proliferation of unfair corporate practices that harm investors generally, which would be a tragically ironic result of the proposed rulemaking under Section 14(a).[309]

The proposed rule amendments would also discourage and diminish competition in the market for proxy advice. This is so for two reasons. First, only the largest proxy advisers would have sufficient human and financial resources to comply with the proposed review, feedback and response-insertion provisions, and to defend themselves against baseless claims by disgruntled

[309] See *supra* at 8.

registrants or other solicitors. Furthermore, if every adviser's opinions and recommendations are vetted by the same parties, there would be an inherent stifling of different views, even if all equally valid.[310] Taken to its absurd conclusion, there may not be a need for any proxy advisers, since what the Commission seemingly considers to be an "accurate and complete" analysis can be supplied by the issuer or other solicitor itself.[311]

Finally, the SEC's economic analysis fails to assess the market effects of the misuse of MNPI that would have to be supplied to registrants and other parties under the review and feedback provisions. As discussed earlier,[312] given the volume of potentially market-moving information that will be released every year, it is likely that some parties will be unable to resist the temptation to trade on, or otherwise misuse, this information, whether it is covered by a confidentiality agreement or not. The moral hazard of such a consequence would lie squarely with the SEC.

Even without a precise calculation of costs, therefore, it is clear that this rulemaking is economically unjustified.

E. Reasonable Alternatives

For the many reasons stated above, the only reasonable alternative to this proposal is to regulate all proxy advisers under the Advisers Act. That approach will constitutionally, lawfully and effectively address any legitimate concerns there may be regarding the accuracy and integrity of proxy voting advice.

CONCLUSION

This rulemaking exceeds the Commission's statutory authority, is unconstitutional, upends almost 90 years of U.S. securities regulation, cannot be reconciled with past Commission statements about, or existing legal requirements applicable to, proxy advisers, is impracticable, and thoroughly lacks economic justification. ISS urges the Commission to take its fingers off the issuers' side of the scale, and—in the interests of investors and the capital markets—withdraw these proposed rule amendments.

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[310] As things stand today, many large institutional investors subscribe to more than one proxy advisory service. *See e.g.* Remarks of Jonathan Bailey, 2018 Roundtable Transcript, *supra* note 76 at 184.

[311] If the subjects of the advice have the right to establish the "correct" methodology, there certainly would not be any need for an adviser to maintain multiple specialty voting policies.

[312] *Supra* at 60-61.