

February 3, 2020

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE Washington, DC 20549-1090
Via SEC Internet Submission Form

Re: File No. 4-725. SEC Staff Roundtable on the proxy process

Dear Ms. Countryman,

The Shareholder Advocacy Forum is a nonprofit, nonpartisan organization dedicated to preserving the long-term interests of all shareholders. We are affiliated with Americans for Tax Reform, also a nonprofit, nonpartisan organization focused on lower taxes and limited government. We appreciate the opportunity granted by the Commission to comment on the proxy process and we wish to propose recommendations that we believe could enhance investor protection and transparency.

The proxy process allows both companies and shareholders to communicate and provides an opportunity for shareholders to present suggestions with the goal of creating long-term value for both the shareholder and the business. There is an urgency to pursue pro-growth reforms within the proxy process that could have a direct impact on the health of public companies, job creation, and the overall quality of the economy while reducing regulatory burdens that encourages more private companies to seek public markets. We encourage the SEC to continue modernizing and pursuing intelligent reforms to the proxy process.

Currently, there is a duopoly of two companies – Institutional Shareholder Services and Glass Lewis - that controls 97% of the proxy advisory business.¹

Additionally, numerous shareholders, academics and members of Congress have been critical of both companies, particularly over their conflicts of interest and a tendency to make factual mistakes when developing vote recommendations.² While proxy advisors can play an important role in corporate governance, their flaws call into question whether retail investors are being served by the existing proxy advisory system.

¹ Larcker, David F., Brian Tayan, James R. Copland, June 14, 2018, The Harvard Law School Forum on Corporate Governance, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, <https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/>.

² US GAO, November 15, 2016, Michael Clements, *Corporate Shareholder Meetings: Proxy Advisory Firms' Role in Voting and Corporate Governance Practices*, <https://www.gao.gov/assets/690/681050.pdf>

According to a June 2007 Government Accountability Office report, ISS noted there are “over 28,000 publicly-traded corporations globally send out proxy statements each year that contain important facts about more than 250,000 separate issues on which shareholders are asked to vote.”³ With the vast amount of shareholder proposals to consider, it is easy to understand the importance for transparency in the proxy advisory business. As the industry has expanded over the past 20 years, several issues of concern have grown with the proxy advisory business as well as various reforms suggested that should be considered in any rules proposed: transparency, conflicts of interest, voting accuracy and ensuring fair, accurate, unbiased voting recommendations.

We applaud the Commission for taking an active role in modernizing several shareholder rules, hosting numerous Roundtables, and providing an opportunity to engage all parties in the overall proxy process.⁴ The Commission has taken steps in the right direction for improving the process and we appreciate the opportunity to provide recommendations for the Commission to consider.

Require Transparency for Conflicts of Interests

A substantial concern the proposal attempts to address which shareholders and businesses have been critical of is whether there are inherent conflicts of interest in proxy advisors’ services with respect to the consulting services that these firms provide. This topic has been emphasized at the Roundtable discussion and the SEC has taken various strides in addressing this problem.⁵ For example, the American Council for Capital Formation’s comment submitted to the Commission in October 2018 discussed the findings from their May 2018 report of the conflicts ISS present with their Governance Advisory Services and their recommendations of the same business’s proposals.⁶ This lack of transparency could harm shareholders if the disclosure of which businesses ISS is providing governance services to *and* providing recommendations for or against proposals of the same business is not brought to light. Other conflicts can also taint the objectivity of voting recommendations – such as when ISS or Glass Lewis issues a recommendation on a shareholder proposal that was submitted by one of the firms’ clients.

In an effort to further increase transparency on behalf of shareholders, the Shareholder Advocacy Forum would like to make several recommendations for the SEC to consider while amending rules that govern proxy advisory services. One approach to transparency would be to require proxy advisors to disclose their recommendations to shareholders of the reason for their support or opposition to the proposal and provide these reasons to the general public. For example, shareholders who own a small position in a publicly listed company are impacted by decisions of all shareholders as it relates to a policy that affects the day-to-day operation of the underlying business. However, for these shareholders who hold limited shares, they cannot view proxy

³ US GAO, June 29, 2007, Jones, Yvonne D., *Corporate Shareholder Meetings; Issues Relating to Firms that Advise Institutional Investors on Proxy Voting*, <https://www.gao.gov/new.items/d07765.pdf>

⁴ Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice.” Securities & Exchange Commission, December 4, 2019. <https://www.federalregister.gov/documents/2019/12/04/2019-24475/amendments-to-exemptions-from-the-proxy-rules-for-proxy-voting-advice>

⁵ US SEC, Nov. 15, 2018, *Roundtable on the Proxy Process*, <https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf>

⁶ Doyel, Timothy M., Oct. 10, 2018, Re: File Number 4-725; SEC Staff Roundtable on the Proxy Process, <https://www.sec.gov/comments/4-725/4725-4494052-175968.pdf>

advisor’s recommendations, reserving the right to view recommendations only to larger shareholders. It is important to keep in mind that retail shareholders – those who own shares of public companies in their retirement accounts – are in most cases the ultimate owner of shares that are being voted on in public companies. It is *their* capital at risk, and as such, there is little reason for them to be left in the dark regarding critical corporate governance matters at companies in which they are invested. If proxy recommendations were made public, it would increase transparency and possibly increase shareholder participation in the voting process.

Proxy Advisors Should Provide Businesses Sufficient Time to Review Recommendations

The Shareholder Advocacy Forum is pleased to see the Commission move in the direction of amending Rule 206(4)–6 under the Investment Advisers Act of 1940 and requiring proxy advisory firms to exercise a duty of care standard on behalf of their clients. In the past, we have seen little recourse when the proxy advisor provides false information to shareholders. For example, as Amanda Panchery noted in her publication for *Morning Consult*,

“In 2011, ISS recommended shareholders vote against Disney’s compensation plan. Their recommendations relied on a practice Disney no longer used and mischaracterized how often Disney tests employee performance. Although the information in the report was not factually sound, Disney took precautions and changed the provisions under scrutiny, filed additional materials, and submitted a letter to shareholders clarifying errors made by ISS. ISS acknowledged its mistakes, but its updated recommendation relied on the same flawed conclusions. Disney’s shareholders ultimately rejected the recommendation by ISS and voted in favor of Disney’s compensation plan, likely because Disney took preemptive actions to clear up concerns.”⁷

This important step will allow the proxy advisors to be held accountable for providing false information to shareholders, eroding shareholder value when recommendations are comprised of misleading information.

We are also happy to see that the Commission is accepting comments to implement a “draft” or review-and-comment process for businesses to study and amend inaccuracies before proxy advisor recommendations are provided to shareholders. Additionally, if proxy advisors are held to a higher duty-of-care standard, and in the pursuit of creating more transparency for shareholders, when recommendations differ from those of the public company’s, the proxy advisors should provide shareholders with a publicly stated and timely explanation in writing as to why their recommendation does not align with the business’s management.

We disagree with critics of the proposal who claim this would give issuers “veto-power”⁸ over proxy advisor recommendations. That is simply not the case: proxy advisors would be free to

⁷ Panchery, Amanda, August 23, 2019, *Morning Consult*, “SEC could Reshape how Shareholders, Businesses Communicate... for the Better”, <https://morningconsult.com/opinions/sec-could-reshape-how-shareholders-businesses-communicate-for-the-better/>

⁸ ISS, Dec. 8, 2016, *Statement of Institutional Shareholder Services Inc. to the Securities and Exchange Commission Investor Advisor Committee: File No. 265-28*, <https://www.sec.gov/comments/265-28/26528-271.pdf>

ignore or disagree with a company’s feedback, but the shareholder would ultimately benefit by having access to more information regarding a particular proxy issue.

By changing the process of how recommendations are distributed to shareholders, allowing for businesses to review recommendations and providing publicly available explanations for recommendations in contrast with management’s, we believe this will improve the quality of information available to shareholders and advisors voting on behalf of their clients.

Expand Opportunity for Shareholders to Review Contested Recommendations Before Automatic Voting

As stated above, we believe it is important that all shareholders are able to review proposed recommendations from the proxy advisors when recommendations vary from those of the business’s management. According to a recent US Chamber of Commerce Center for Capital Markets Competitiveness survey, 87% of the companies surveyed had a proxy advisory business provide a recommendation for at least one proposal that was included on a public company’s proxy statements.⁹ Among businesses surveyed, “only 39% of companies believ[e] that proxy advisory firms carefully researched and took into account all relevant aspects of an issue on which it provided advice,” while “only 21% of companies surveyed asked for opportunities to meet with proxy advisory firms on matters subject to a shareholder vote.”¹⁰

The automatic voting-of-shares or “robo-voting” policies from investment advisors or mutual funds on behalf of clients upon the release of proxy advisor recommendations presents a challenge when recommendations are based on inaccurate or incomplete analysis and data. Significantly, the burden of proof for inaccuracies rest with the businesses to inform all shareholders, especially those that have already voted. As Darla Stuckey, President and CEO of the Society for Corporate Governance noted in her June 28, 2018 testimony before the Senate Banking Housing and Urban Affairs Committee, a member of the Society provided an anecdote to describe the difficulty of engaging with the proxy advisors and reversing votes case:

As a small-cap company, unlike larger companies, we are not given a ‘preview’ of our report from ISS, so we received this report just 2 weeks prior to our May 2016 annual meeting. We quickly utilized all of the methods available to us to try to get the error corrected and the recommendation reversed. Although ISS acknowledged the error, they declined to issue either a correction or a revised report. We engaged in robust shareholder outreach as we have for many years, and while the shareholders who were able to speak with us quickly understood the mistake and supported our Say-on-Pay [proposal], we were not able to have meetings with all the shareholders we reached out to due to the extremely busy proxy ‘inseason’ and a large portion of our shareholders being quantitative or passive firms who outsource their voting to proxy advisory firms.

⁹ US Chamber of Commerce, Center for Capital Markets, 2019, *2019 Proxy Season Survey*, https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/11/CCMC_ProxySeasonSurvey2019_v2-DIGITAL.pdf

¹⁰ Ibid., *2019 Proxy Season Survey*

The result was that our 2016 Say-on-Pay [proposal] narrowly failed with a 49.8% favorable vote outcome.¹¹

Additionally, in Exxon Mobil's July 26, 2019 comment letter to the Commission, Exxon provided a measurable example of the proxy advisor's recommendations for proposals: "Our data suggests that at least 15% of our shares are voted immediately upon the release of ISS' benchmark report (i.e., before shareholders could reasonably read the report or the company would have had an opportunity to address the analysis)."¹²

These are a few of the many examples of the challenges shareholders and businesses face with correcting inaccurate information provided to shareholders when automatic voting has taken place. Alternatively, there is a need for automatic voting practices, especially for mutual funds. As George Mason University professor J.W. Verret noted in his April 13, 2019 comment letter to the Commission, it would be extremely difficult for a "single mutual fund to diligently vote on 100,000 items annually."¹³ While there may be supporters and those that oppose the automatic voting issues, we recognize the complexity and challenges shareholders, investment advisors and businesses face with automatic voting practices. In addition to allowing businesses to review proposed recommendations, we recommend the Commission study the effects of a policy that allows for automatic voting to be briefly suspended if there is a dispute over a proposal between the proxy advisor and the business's recommendations. We believe this could enhance shareholders ability to review all relevant information and weigh both recommendations and data before voting.

In addition to these comments, we are happy to see the reforms included in amendments to Rule 14a-9 as we believe these amendments will help increase transparency for proxy advisors while also enhancing their duty-of-care responsibilities. We applaud the commission for their willingness to thoughtfully engage all stakeholders through your Roundtable series and we commend the Commission for considering various amendments toward improving the proxy-voting system.

If you should have any questions or comments, please contact James Setterlund by phone at [REDACTED], or email at [REDACTED] or [REDACTED].

Sincerely,



James L. Setterlund
Executive Director, Shareholder Advocacy Forum

¹¹ Stuckey, Darla, June 28, 2018, testimony before the Senate Banking Housing and Urban Affairs Committee, Hearing entitled *Legislative Proposals to Examine Corporate Governance*, <https://www.banking.senate.gov/imo/media/doc/Stuckey%20Testimony%2006-28-18.pdf>

¹² Hansen, Neil A., July 26, 2019, *Roundtable on the U.S. Proxy Process File No. 4-725*, <https://www.sec.gov/comments/4-725/4725-5879063-188728.pdf>

¹³ Verret, J.W., April 13, 2019, *Re: File No. 4-725 - SEC Staff Roundtable on the Proxy Process*, <https://www.sec.gov/comments/4-725/4725-4595389-176341.pdf>