February 1, 2020

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

Re: S7-22-19 - Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice

Dear Ms. Countryman:

I would like to submit the attached blog post for Promarket.org that David Larcker and I wrote in support of the proposed rules on proxy voting advice.

Sincerely,

Why We Favor The SEC's Proposal on Proxy Advisor Regulation

Luigi Zingales and others on this blog (Promarket.org) have criticized the SEC's proposal on proxy advisor regulation. While, it may appear that their opinion is unanimous, it assuredly is not. There are many good reasons to support the proposal.

First, it is worth explaining the problem the proposal is designed to address. As detailed in the attached piece (co-authored by one of us): (1) proxy advisory firms lack transparency; (2) institutional investors are influenced by the proxy advisory firms; (3) corporations are influenced by proxy advisory guidelines – in some cases, hiring the proxy advisors as consultants in an effort to improve ratings; and (4) proxy advisory firm recommendations may not be in the best interests of shareholders.

As Robert Jackson notes in his post, there are instances in which proxy advisory firms' recommendations increase shareholder value, particularly with proxy contests where we suspect research teams with greater expertise are engaged. However, he does not mention in his post the generally negative shareholder impact of advisory firm recommendations, combined with their lack of transparency and conflicts of interest.

We are not sure that Robert Jackson, Luigi Zingales and others appreciate the large amount of time that boards spend responding to the proxy advisory firms that might be better spent on other governance matters. Having served on several public company boards, we have seen a number of instances in which boards were rationally influenced by proxy advisory guidelines in ways that did not increase shareholder value, but did utilize valuable resources. One wonders whether this is just one more – of many reasons – for the decline in public companies and the ascendancy of private equity in the U.S.

In a normal market, companies with a poor service record are driven from the market. Proxy advisory firms, however, appear to be insulated from these forces. The dominance of ISS and Glass Lewis — despite evidence that their recommendations are inaccurate and potentially value-destroying to shareholders — suggests that a market failure has occurred.

Where market failure occurs, some regulatory response is warranted. One solution would be to reduce the regulatory demand for proxy advisory services by eliminating the requirement that institutional investors vote all items on the proxy. The other solution would be to increase regulatory standards to improve advisory firms' accuracy, transparency, and accountability. The SEC has proposed the second solution.

The SEC proposals are meant to "(i) improve proxy voting advice businesses' disclosures of conflicts of interests that would reasonably be expected to materially affect their voting advice, (ii) establish effective measures to reduce the likelihood of factual errors or methodological weaknesses in proxy voting advice, and (iii) ensure that those who receive proxy voting advice have an efficient and timely way to obtain and consider any response a registrant or certain other soliciting person may have to such advice."

If the proposal is enacted, it will induce the proxy advisory firms to provide greater transparency and accountability. At the same time, it is unlikely to thwart the proxy contests that appear to be beneficial to shareholders. Activists and other shareholders will continue to have large stakes in these contests. The proxy advisory firms appear to have been doing a creditable job on these. There is little reason to think enhanced disclosure will change this.

Steven Kaplan and David Larcker