BIPARTISAN POLICY CENTER

February 3, 2020

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F St., NE
Washington, DC 20549

Re: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice
Release No. 34-87457
File No. S7-22-19

Dear Ms. Countryman:

In recent years, investors and advocacy organizations have become more active in using corporate governance structures, such as proxy voting, to affect business decisions on issues ranging from environmental protection to gun control to human rights. This trend, which shows no sign of abating, begs the broader question of the extent to which the private sector should engage on public policy issues, and more specifically whether the current corporate governance structure was designed to facilitate these activities.

In 2019 BPC launched our corporate governance project. One of the focuses of the project is examining how companies address rising stakeholder pressures, while continuing to maximize shareholder value. One issue is that a growing number of stakeholders are seeking to influence companies through the shareholder proposal process. As a result, accurate information in the proxy process is paramount to all investors in this changing environment.

In 2019 institutional investor Vanguard voted on over 169,000 proposals.[1] The New York City comptroller's office cast 71,000 ballots at 7,000 shareowner meetings in the first 6 months of 2018.[2] One can certainly understand why many institutional investors look to proxy advisors for help in navigating all of these proposals. However, concerns have been raised about some of the proxy advisor recommendations and whether there should be more oversight and transparency around the proxy process and their recommendations to investors.

As means of background, the BPC has hosted three public events as well as private roundtables on these important issues. We have been closely following the SEC actions on these matters since the November 2018 roundtable. This past year we spent engaging with stakeholders, public officials, and other thought leaders.

On January 27, 2020, BPC hosted *The Proxy Process Reformed*, a discussion of proposed rule Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice. We had panelists Pat McGurn, Special Counsel and Head of Strategic Research and Analysis at Institutional Shareholder Services, Inc. (ISS) and Tom Quaadman, Executive Vice President at U.S. Chamber of Commerce Center for Capital Markets Competitiveness

[1] https://www.sec.gov/comments/4-725/4725-6168191-192387.pdf
[2] Id.

(U.S. Chamber). *The debate between ISS and the U.S. Chamber forms the basis for BPC's submitted comments regarding this rule.*

Is There Need for Reform?

The growth of mutual fund and exchange-traded funds has given proxy advisory firms a growing influence on the shareholder proposal process. As a result, asset managers have come to rely on proxy advisory firms to alleviate their conflicts of interest, help in the mechanics of voting, and fulfill their perceived fiduciary duty to vote each share.

Whether the changing landscape is simply a result of market forces that should be allowed to continue to evolve naturally; or rather it is a signal that additional oversight is warranted is a question the Commission must grapple with as it evaluates comments to its proposed rule. Regardless of the position you take, when a market changes this profoundly additional oversight is prudent, at the very least, to avert any potential unintentional consequences.

There is a clear distinction in opinion on whether the SEC should engage in a rulemaking in this area. There is however some indication that the SEC is already thinking about this proposed rule from a broader historical perspective. As SEC Commissioner Roisman has indicated, an asset manager's reliance on proxy advisory firms to both alleviate their own conflicts of interest as well as fulfil their fiduciary duty to their clients in voting each share may have been based on a misplaced interpretation of prior SEC guidance.[3] As a result, the SEC has advised asset managers that their conflicts of interest and decisions on voting shares should be based on their fiduciary duty to their clients, and not indemnified by following the recommendations of proxy advisors.[4] Focusing on the individual or retail investor's interests appears to be a theme that will likely be woven throughout the analysis of the SEC's rulemaking.

Therefore, to answer the ultimate question of regulating in the area, we suggest importantly that any finalized rule should "do more good than harm." While there are certainly arguments that can be made that the status quo is desirable, given the changing dynamics of the proxy process the SEC should, through careful review, conduct oversight of the proxy process through this rulemaking process.

Conflicts of Interest

There are two types of conflicts of interest, one of which is unique to ISS. ISS offers recommendations on proposals that are submitted for a vote at the same issuer to whom they offer consulting services on how to change or obtain a favorable recommendation.

ISS has explained that they have developed a process for addressing these types of conflicts by creating a "firewall" to insulate the different business lines. This process is based on guidelines that they use to determine the extent of the conflict. While actual

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[3] SEC Commissioner Elad Roisman, March 18, 2019 Keynote Remarks: *ICI Mutual Funds and Investment Management Conference,* available at: https://www.sec.gov/news/speech/speech-roisman-031819

[4] *See* SEC August 21, 2019 Press Release, *SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice*, available at: https://www.sec.gov/news/press-release/2019-158

conflicts are not revealed, if one exists and to the extent that it's determined internally, clients are notified. In addition, they claim that any attempt to require them to disclose actual conflicts will have the unintended consequences of weakening or destroying the firewall they are required to maintain.

Proponents of the rule have indicated that revealing guidelines to the assessment process used to determine conflicts of interest is not sufficient to alleviate the appearance of impropriety. Further, the U.S. Chamber indicated that a survey of 172 companies during the 2019 proxy season indicated that 58% of those companies who received a negative vote recommendation from ISS were contacted by the alleged firewalled consulting services.

The second potential conflict of interest is that some of the proxy advisors provide analyses to the same entities that regularly submit shareholder proposals at various issuers' annual meetings. At the January 27 BPC event, the U.S. Chamber indicated that ISS does not publicly list clients that submit proposals that will be reviewed by ISS, and as such there is no oversight to ensure that the policies and procedures are followed. ISS countered that it has a robust system and set of policies that prevent conflicts from inappropriately affecting their decisions and notifies clients of those conflicts when the arise. Again, the issue is not about whether there are conflicts, as they do occasionally occur, rather whether there are sufficient procedures in place to address the conflicts when they occur.

The SEC should review the policies and procedures used to mitigate the potential conflicts of interest in a way that is transparent and helpful to all investors. In so much as the proposed rule addresses actual conflicts, the SEC's oversight is vitally important. The rule should not undermine any procedures, such as a robust firewall, that have been put in place to address actual conflicts. If disclosure can be done in a way that achieves that goal, then we would be supportive so much as it increases transparency. As the use of shareholder proposals continues to evolve, we think it is important that the process is as open and transparent as possible so that investors have all the necessary information to make an informed decision.

Errors in Reports

As with the conflicts of interest, there are also differing views on the amount of errors proxy advisory firms commit in their analyses and therefore, what affect, if any, they have on shareholder decisions. At BPC's January event, ISS indicated that they track errors in their reports and found that the error rate is less than one percent. Moreover, ISS claims that a significant portion of the errors are not "errors' but rather differences of opinion over subjective analysis and methodology and therefore, it is not an issue in need of addressing. To ensure accuracy, they engage year-round with S&P 500 companies and give draft reports to issuers 20 days in advance. Another leading advisory firm, Glass Lewis' Issuer Data Report is used to facilitate timely communication with issuers over errors.

Many who submitted comments for the SEC's November 2018 roundtable on proxy advisors correctly noted that the proxy advisors' duty is not to the issuer but to the investor who has contracted with them for assistance. Because of this duty and the low error rate, ISS warns that if the rule goes through as proposed, it will rush the process

unnecessarily and the 3-day review-and-comment period will prevent a truly open process.

However, with regard to ISS, the U.S. Chamber claims that 3,700 public companies do not have the ability to interact with ISS regarding errors. The U.S. Chamber argues the error rate is likely closer to 2.5% at a minimum, given that not all issuers file subsequent reports with the SEC documenting the errors.[5] In addition, proponents of reform argue the number of issuers that are requesting meetings with proxy advisors has declined noticeably, even though the error rate has not. As a result, the U.S. Chamber contends that the 3-day rule will force a dialogue with the issuer, which will result in more accurate reports and overall better transparency. The hyperlink provision is a way to ensure that differences of opinion are disclosed to the investor.

There is clearly a disagreement on the actual numbers and types of errors. However, ISS and the U.S. Chamber could both be correct. If the *reported* error rate is less than one percent and there's evidence that errors do go unreported, the actual error rate may be at a minimum less than one percent as ISS claims and up to if not more than least 2.5 percent as the U.S. Chamber claims. When tens of thousands of proposals are voted on every year, even a small percentage of errors could have profound effect on the information that is used to cast those votes. We encourage the SEC to proceed with requirements to give issuers time to identify errors and to ensure that the timeline as outlined in the rule will not cause delay for the investor community. The hyperlink seems a cost-effective way to provide up-to-date information to investors.

Automatic and Robo-voting

We realize that the SEC does not include provisions in the rule on automatic or what's been referred to as robo-voting, though they do ask for comments on the issue. We have found that this area was one that is being frequently discussed when the proposed rule is debated.

ISS indicates that one of the ways they address that potential problems with errors being exacerbated by automatic-voting is that they give their clients alerts, through their "Proxy Alert" platform. As a result, clients are made aware of relevant errors in their reports and can change their votes, if they choose, accordingly. Moreover, pre-populated ballots are based on custom reports, as opposed to their benchmark reports. Therefore, the clients have already pre-determined how they will vote on many of the issues covered in the proposal process. As for robo-voting, ISS claims that the problem is fabricated. Clients, many of whom use the reports as a check on their own analysis, are the ones who determine what criteria they use to vote, and they have an annual review of our polices for our benchmark reports.

The U.S. Chamber argues that that process is not sufficiently robust to address the magnitude of the problem. According to one report, up to 20% of voting occurs in substantial numbers within the three days of the release of the report.[6] If there are

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[5] *See* Letter to the SEC from Ken Bertsch, Executive Director, Council of Institutional Investors (CII) ("we would expect that there are other undocumented errors"), available at: https://www.sec.gov/comments/4-725/4725-6357861-196392.pdf.

[6] Frank M. Placenti, *Are Proxy Advisors Really a Problem?,* the American Council on Capital Formation (October 2018), available at: https://accfcorpgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf.

substantial errors in the reports, votes would be based on incomplete information, which in some cases could have profound effects on establishing the fiduciary duty asset managers owe to their clients. Moreover, with the use of pre-populated votes based on a pre-determined set of criteria, there may be insufficient time to change one's vote if an erroneous report is relied upon.

While automatic voting with pre-populated votes saves investors time, the issue is whether there are sufficient enough safety mechanisms in place to "alert" investors of potential errors in reports before those votes are automatically submitted. Disabling the automatic function of submitting pre-populated votes, when there has been an objection raised, certainly seems like it would help ensure that errors in reports and subsequent recommendations are not able to have a negative multiplier effect on the outcome of any given vote. The need for a disabling function should be alleviated or altogether unnecessary if a more robust engagement process was adopted as previously discussed.

While there is certainly circumstantial evidence that robo-voting occurs, and in significant numbers to warrant review, however, the question becomes, what can practicably be done to ensure that robo-voting doesn't undermine the fiduciary duty owed to the ultimate investor. The SEC's recent guidance has indicted that asset managers owe an ultimate duty to the shareholder and that can't be transferred.[7] So determining whether robo-voting is merely a symptom of a process in need of reform or a cause of votes being cast without the predict analysis of an asset manager's fiduciary duty to the shareholder is an issue the SEC must address. The provisions of the proposed rule as well as the recent guidance as discussed is this comment will help alleviate many of the identified concerns associated with robo-voting.

In conclusion, we believe that proxy advisory firms are a necessary part of the shareholder proposal process, and ISS in particular, has thoughtfully responded to many of the criticisms leveled at it. We are confident that ISS and other proxy advisors will continue to effectively represent their clients and be a vital part of the proxy process.

As for the proxy industry, we support common sense solutions to a number of the previously identified issues. We do support clarifying the fiduciary duty owed to the investors, facilitating increased engagement between proxy advisory firms and issuers, including a reasonable review-and-comment period for objections and when necessary the insertion of a hyperlink, and disabling automatic voting capabilities when there is a valid objection raised as to the accuracies of the information so that investors are fully informed.

We appreciate your attention to these issues and the opportunity to share our recommendations. BPC's Corporate Governance Project will continue to facilitate discussions and work on bipartisan solutions to identified problems and inefficiencies in the capital markets.

If you would like to discuss further, please contact me at [redacted].

Sincerely,

[7] *See* SEC August 21, 2019 Press Release, *SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice*, available at: https://www.sec.gov/news/press-release/2019-158

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