



February 3, 2020

Ms. Vanessa Countryman
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549
VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: File Number S7-22-19:

Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice

Submitted by: James R. Copland

Dear Ms. Countryman:

I appreciate the opportunity to comment on the Commission's proposed rulemaking, "Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice" (File No. S7-2-19, Release No. 34-87457). I am a senior fellow with the Manhattan Institute for Policy Research, a non-profit, non-partisan think tank that develops and disseminates ideas that foster economic choice and individual responsibility.¹ Since 2003, I have served as the Institute's director of legal policy.² In 2011, the Institute launched ProxyMonitor.org, a publicly available database cataloging shareholder proposals and shareholder advisory votes on executive compensation at America's largest companies.³ Since that time, I have devoted significant time to researching the shareholder-proposal process under the SEC's Rule 14a-8,⁴ including analysis of how the proxy-advisory industry affects that process. I have testified on this subject matter before committees and subcommittees of the United States Senate⁵ and United States House of Representatives,⁶ in

¹ See About MI, <https://www.manhattan-institute.org/about>. My comment letter reflects only my own views, not my employer's. Some commentary is excerpted from my own prior writings, listed in the appendix, without attribution.

² See James R. Copland, <https://www.manhattan-institute.org/expert/james-r-copland>.

³ See About Proxy Monitor, <https://www.proxymonitor.org/Forms/About.aspx>.

⁴ See 17 CFR 240.14a-8.

⁵ See Statement of James R. Copland, "Who's Monitoring the Monitors? The Rise of Intermediaries and the Threat to Capital Markets," Hearing before the Senate Committee on Banking, Housing, and Urban Affairs: The Application of Environmental, Social, and Governance Principles in Investing and the Role of Asset Managers, Proxy Advisors, and Other Intermediaries, Apr. 2, 2019, available at <https://www.banking.senate.gov/imo/media/doc/Copland%20Testimony%204-2-191.pdf>.

⁶ See Statement of James R. Copland, "SEC Rule 14a-8: Ripe for Reform," Hearing before the House Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises: Hearing on Corporate Governance: Fostering a System that Promotes Capital Formation and Maximizes Shareholder Value, Sept. 21, 2016, available at <https://media4.manhattan-institute.org/sites/default/files/T-JC-0916.pdf>; see also Statement of James R. Copland, "Economic Growth and Efficient Capital Markets: An Agenda at Odds with Subcommittee's Bills Under Consideration," Hearing before the House Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets: Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers, May 15, 2019, available at https://media4.manhattan-institute.org/sites/default/files/Testimony_JCopland_051519.pdf.

addition to authoring a number of reports, articles, and other writings on the subject.

I have submitted a more-exhaustive comment to File No. S7-23-19, summarizing my research on the shareholder-proposal process more broadly and commenting on Release No. 34-87458, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8. I incorporate those comments here by reference, in addition to my earlier writings included here in an appendix.

I am broadly supportive of the approach proposed in Release No. 34-87457. I have called for the SEC to take a closer look at proxy advisory firms since 2012,⁷ when my research indicated that a single proxy adviser, ISS, affected shareholder voting on shareholder proposals submitted under Rule 14a-8 to a substantial degree.⁸

I would particularly like to call the Commission's attention to my most comprehensive research into this subject, a 2018 Manhattan Institute report I co-authored with Stanford Professors David Larcker and Brian Tayan, *Proxy Advisory Firms: Empirical Evidence and the Case for Reform*, which the SEC staff cited in this proposed rulemaking release;⁹ and a companion report issued as part of the Stanford Business School Closer Look Series.¹⁰ These reports summarize much of the best empirical evidence about proxy advisory firms in the academic literature. Professors Larcker, Tayan, and I conclude:

Regulation of the proxy advisory industry might be necessary. To be sure, there is conflicting evidence about how proxy advisory firms' guidance and recommendations affect shareholder value—with some evidence showing positive rather than negative effects when it comes to proxy contests. It might be the case that proxy advisory firms use research teams with greater expertise, as well as more customization, when evaluating complex, high-value proxy issues. Still, the generally negative impact of advisory firm recommendations, combined with a lack of transparency and conflicts of interest, would make little sense in a properly functioning 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.¹¹

The shareholder voting process is beset with collective-action problems that lead to these market failures in the proxy-advisor industry, as Bernard Sharfman ably explained in his comment letter on

⁷ See James R. Copland, *Politicized Proxy Advisers vs. Individual Investors*, WALL ST. J., Oct. 7, 2012, available at <https://www.manhattan-institute.org/html/politicized-proxy-advisers-vs-individual-investors-3863.html>.

⁸ See James R. Copland with Yevgeniy Feyman & Margaret O'Keefe, *Proxy Monitor 2012: A Report on Corporate Governance and Shareholder Activism* (Manhattan Institute 2012), available at https://www.proxymonitor.org/Forms/pmr_04.aspx.

⁹ James R. Copland, David F. Larcker & Brian Tayan, *Proxy Advisory Firms—Empirical Evidence and the Case for Reform*, (Manhattan Institute 2018), available at <https://media4.manhattaninstitute.org/sites/default/files/R-JC-0518-v2.pdf>.

¹⁰ James R. Copland, David F. Larcker & Brian Tayan, Stanford Business School Closer Look Series, *The Big Thumb on The Scale: An Overview of the Proxy Advisory Industry* (2018), available at <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closerlook-72-big-thumb-proxy-advisory.pdf>.

¹¹ See Copland et al., *supra* note 7, at 6.

this rulemaking release.¹² The SEC has previously acknowledged this collective-action problems in earlier rulemakings, dating to the genesis of the proxy-advisory industry itself.¹³

I am sensitive to the view—expressed by dissenting commissioners and in some of the plethora of comment letters engineered for submission in opposition to this release—that we should be sensitive not to exacerbate existing failures in the shareholder-voting and proxy-advisory industry by erecting needless regulatory barriers to entry. But as professors Larcker, Tayan, and I note in our report, “given the evidence—an industry dominated by two firms and low revenues relative to overall stock market impact—the potential that regulatory requirements may create new barriers to entry is less salient than it might be in the ordinary case.”¹⁴ That said, I would look favorably upon the recommendation by the Council of Institutional Investors that “proxy advisors that have annual gross receipts in an amount that is not more than \$5,000,000, and/or that are 501(c)(3) organizations, be exempt from the proposed additional conditions to the exemptions.”¹⁵

But make no mistake: there is a problem, and the SEC is to be applauded for taking it seriously. The proxy-advisory industry is concentrated in a duopoly. Two small, thinly capitalized firms with relatively small staffs and low profits—one of which is wholly owned by a foreign pension fund for a public teachers’ union—exert extraordinary market influence. Together, these two proxy advisors control approximately 97% of the market for proxy advisory services, with ISS alone having about a 61% share.¹⁶

A 2012 analysis I lead authored for the Manhattan Institute found that an ISS recommendation “for” a given shareholder proposal—controlling for other factors including company size, industry, proponent type, proposal type, and year—was associated with a 15-percentage-point increase in the shareholder vote for any given proposal.¹⁷ Thus, in the shareholder-proposal context, ISS acts like a 15% owner of the largest publicly traded companies in terms of its influence over the voting market. Other studies, looking at other voting items using other methodologies, find varying degrees of influence, as professors Larcker, Tayan, and I discuss in our report.¹⁸ But although “is disagreement about the degree to which they influence these outcomes,” it is clear that “that proxy advisors have a material, if unspecified, influence over institutional voting behavior and therefore also voting outcomes.”¹⁹

Notwithstanding its influence, ISS is a relatively small operation. Prior to its 2014 acquisition by Vestal, ISS was owned by MSCI, a publicly traded company; at that time, it had just over \$15 million in profits on \$122 million in revenues.²⁰ (A significant fraction of those revenues came not from

¹² See Comment from Bernard S. Sharfman, Dec. 20, 2019, available at <https://www.sec.gov/comments/s7-22-19/s72219-6571096-201082.pdf> (discussing shareholder-voting collective-action problem).

¹³ See, e.g., Proposed Disenfranchisement Rule, 52 Fed.Reg. 23,665, 23,672/1 (1987) (discussing shareholder-voting collective-action problem).

¹⁴ See Copland et al., *supra* note 7, at 19.

¹⁵ Comment from Council of Institutional Investors, Jan. 30, 2020, at 4, available at <https://www.sec.gov/comments/s7-22-19/s72219-6729687-207381.pdf>.

¹⁶ See James K. Glassman and J. W. Verret, How to Fix Our Broken Proxy Advisory System 8 (Mercatus Center, George Mason Univ., 2013), available at https://www.mercatus.org/system/files/Glassman_ProxyAdvisorySystem_04152013.pdf.

¹⁷ See Copland et al., *supra* note 8.

¹⁸ See Copland et al., *supra* note 7, at 11–13.

¹⁹ *Id.*

²⁰ See MSCI 2013 Annual Report 70, “Summary of Operations,” “Governance.”

sales to the institutional- investment community itself but rather from the company’s “Corporate Sales” division, which offers governance and proxy advice to corporations—in essence, the very companies on whose proxies ISS advises institutional investors on how to vote. In 2013, ISS’s Corporate Sales group generated 29% of its revenues, up from 21% two years earlier.²¹⁾

The probable reason for the disconnect between ISS’s cash flows and influence is that institutional investors simply do not place a very large economic value on the services it offers—based on the collective-action problem Mr. Sharfman discusses in his comment letter. In almost all situations, there is little competitive advantage to be gained from being a “better voter” on proxy items, at least those proposed by shareholders through the 14a-8 process.²² Large institutional investors with sufficient resources to make their own proxy voting decisions and not lose appreciable cost advantage to competitors surely find ISS’s analytical tools useful, but rely little on their proxy voting guidelines. But smaller funds wanting to minimize their investment in voting find hiring ISS a useful way to discharge fiduciary voting obligations at low cost. The very fact that the cost is low—as recently as 2013, ISS grossed less than \$80 million in annual revenues²³ for its services to institutional investors—shows that ISS’s services are not that highly valued by institutional investors, which also helps explain the lack of significant competitors and dearth of new entrants into the proxy advisory space.

Such forces enable ISS (and Glass Lewis) to support ballot items that are generally rejected by most investors, without fear of reprisal. My research shows that ISS has, historically, been almost eight times as likely as the median shareholder to support a shareholder proposal.²⁴ Although the gap between ISS recommendations and the median shareholder could be explained by simple disagreement, it is worth noting that an increase in shareholder voting support for various proposals also increases the incentive for public companies to enter into consulting contracts with ISS to mitigate such costs. In addition, the absence of market constraints on ISS means that it may be highly subject to capture by some of its clients who do place more emphasis on shareholder ballot items than do other institutional investors and most individual investors— namely, labor pension funds and social-investing funds, each of which are very active in sponsoring proposals.

Even if ISS support is generally unlikely to tip the balance of shareholder support in favor of a given proposal—and the evidence suggests that it is not, at least for social and policy proposals—the 15-percentage-point bump that an ISS “for” recommendation tends to generate will ensure that with ISS support, shareholder-proposal activists’ preferred issues remain on the proxy ballot as long as their proponents wish them to remain there, under current SEC resubmission standards. (Under the rulemaking proposed in Release No. 34-87458, this “gatekeeper power” for the largest proxy advisory firm would be somewhat curtailed.)

²¹ Compare *id.* at 10 with MSCI 2011 Annual Report 9.

²² Cf. BRYAN CAPLAN, *THE MYTH OF THE RATIONAL VOTER* (2007). Institutional investors compete aggressively for investor dollars, and they gain competitive advantages largely through higher returns and lower fees. Investing in proxy-voting information raises institutional investors’ costs while giving no competitive advantage in increasing investment returns, at least for smaller, diversified investors who have low ownership shares—and whose individual votes on proxy ballot items are therefore unlikely to be dispositive. For a fuller discussion of these dynamics, see Sharfman, *supra* note 12; see also James K. Glassman & Hester Peirce, *How Proxy Advisory Services Became So Powerful* (Mercatus Ctr., June 18, 2014), <http://mercatus.org/publication/how-proxy-advisory-services-became-so-powerful>.

²³ At least as of 2013, just over \$79 million of ISS’s revenues come from its advisory services business, as opposed to corporate contracts. See MSCI 2013, *supra* note 20, at 9–10.

²⁴ See Copland et al., *supra* note 8, at 23.

In sum, I think the proposed rulemaking is a valuable step toward improving accuracy, transparency, and accountability in the proxy-advisory industry, as professors Larcker, Tayan, and I called for in our report. The Commission should consider exempting smaller proxy advisers from the new rule's requirements, to facilitate entry—although we should not necessarily expect entry, since the collective-action issues infecting institutional shareholder voting should be expected to lead to continued market failure.

On the following page, I have listed additional writings in this area that I ask be incorporated by reference. Please feel free to reach out to me, through the Manhattan Institute, about my testimony or any of the appended writings. Thank you for your time and consideration.

Respectfully submitted,

James R. Copland
Senior Fellow and Director, Legal Policy, Manhattan Institute for Policy Research

Appendix: Additional Writings

Please incorporate by reference this sampling of additional testimony, reports, and other writings authored or co-authored by me or published under my direction by the Manhattan Institute.

Testimony

Statement of James R. Copland, “Economic Growth and Efficient Capital Markets: An Agenda at Odds with Subcommittee’s Bills Under Consideration,” Hearing before the House Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets: Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers, May 15, 2019, *available at* https://media4.manhattan-institute.org/sites/default/files/Testimony_JCopland_051519.pdf.

Statement of James R. Copland, “Who’s Monitoring the Monitors? The Rise of Intermediaries and the Threat to Capital Markets,” Hearing before the Senate Committee on Banking, Housing, and Urban Affairs: The Application of Environmental, Social, and Governance Principles in Investing & the Role of Asset Managers, Proxy Advisors, and Other Intermediaries, Apr. 2, 2019, *available at* <https://www.banking.senate.gov/imo/media/doc/Copland%20Testimony%204-2-191.pdf>.

Statement of James R. Copland, “SEC Rule 14a-8: Ripe for Reform,” Hearing before the House Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises: Hearing on Corporate Governance: Fostering a System that Promotes Capital Formation and Maximizes Shareholder Value, Sept. 21, 2016, *available at* <https://media4.manhattan-institute.org/sites/default/files/T-JC-0916.pdf>

Manhattan Institute Reports

James R. Copland, David F. Larcker & Brian Tayan, *Proxy Advisory Firms—Empirical Evidence and the Case for Reform*, (Manhattan Institute 2018), *available at* <https://media4.manhattaninstitute.org/sites/default/files/R-JC-0518-v2.pdf>.

James R. Copland & Margaret M. O’Keefe, *Proxy Monitor 2014: A Report on Corporate Governance and Shareholder Activism* (Manhattan Institute 2014), *available at* https://www.proxymonitor.org/Forms/pmr_09.aspx.

James R. Copland with Yevgeniy Feyman & Margaret O’Keefe, *Proxy Monitor 2012: A Report on Corporate Governance and Shareholder Activism* (Manhattan Institute 2012), *available at* https://www.proxymonitor.org/Forms/pmr_04.aspx.

Other Report

James R. Copland, David F. Larcker & Brian Tayan, Stanford Business School Closer Look Series, *The Big Thumb on The Scale: An Overview of the Proxy Advisory Industry* (2018), *available at* <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closerlook-72-big-thumb-proxy-advisory.pdf>.

Column

James R. Copland, *Politicized Proxy Advisers vs. Individual Investors*, WALL ST. J., Oct. 7, 2012, *available at* <https://www.manhattan-institute.org/html/politicized-proxy-advisers-vs-individual-investors-3863.html>.