Center On Executive Compensation

February 3, 2020

VIA Electronic Delivery

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

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

Dear Ms. Countryman:

The Center On Executive Compensation ("Center") is pleased to submit comments to the Securities and Exchange Commission ("Commission") providing its perspective and support of the determination that proxy voting advice constitutes a solicitation and the proposed changes to the proxy advisory firm exemption to the federal proxy solicitation rules. The Center believes the Commission has proposed a set of sensible updates which facilitate needed changes to the proxy process.

The changes proposed by the Commission add reasonable and necessary structure to the proxy advisory firm report process which will go a long way to remedying the most significant problems experienced by Center Subscribers, who are Chief Human Resources Officers and Executive Compensation professionals. Further, the proposed changes do so in a way which recognizes the efficiencies investment managers gain through the proper use of proxy advisory firm recommendations as well as the need for proxy advisory firm impartiality.

The Center brings a unique issuer perspective to the discussion of the proxy process and proxy advisory firms. The Center provides extensive executive compensation and corporate governance public policy insight to the top human resources and executive compensation professionals at more than 140 subscribing companies. The commentary in this letter reflects the views and concerns of the human resources and executive compensation professionals at major U.S. public companies who regularly interact with proxy advisory firms.

I. Executive Summary

The Center On Executive Compensation fully supports the Securities and Exchange Commission's proposed changes introduced on November 5, 2019. As a foundational point, the Center strongly supports the Commissions' straightforward and logical decision to codify through rulemaking that proxy voting advice generally constitutes a solicitation as established in the Securities Exchange Act of 1934. Further, by engaging in a solicitation, the Commission has rightfully determined that a proxy advisory firm is subject to liability for false and misleading statements as established in Exchange Act Rule 14a-9.

Additionally, if implemented, the proposal provides *all* issuers with a defined review period for both the draft and final proxy advisory firm proxy reports prior to general publication to the proxy advisory firm's clients. The Center *strongly supports* this needed and balanced change.

For many institutional investors, proxy advisory firm services represent the least expensive manner for evaluating management and shareholder proposals, voting proxies, and fulfilling fiduciary standards.[1] However, that same market reality for proxy advisor services gives the firms – and specifically Institutional Shareholder Services (ISS)[2] and Glass Lewis (GL)[3] – tremendous influence over proposals directing executive compensation, corporate governance, and stakeholder management practices. However, despite this level of influence, the proxy advisory firms are not required to bear responsibility for their reports and resist input from the issuers covered in the reports.

SEC oversight of proxy advisory firms occurs when the proxy advisory firm make solicitations. We support the Commission's position in the proposed rules that these recommendations are indeed solicitations and we believe the Commission should apply the criteria set out in the proposed rules as the standards by which all parties' communications should be evaluated to determine if they are solicitations.

Through the exemption to the proxy solicitation rules, the Commission has the ability to set standards of conduct and thresholds for disclosures that proxy advisors provide in these solicitations. The proxy disclosure and voting processes have evolved significantly over the last 15-20 years. The current proxy advisory firm exemption to the solicitation rules did not envision the current market or the role proxy advisory firms play within the modern proxy process framework. Thus, the current criteria to meet the solicitation exemption for proxy advisory firms are insufficient to achieve meaningful oversight of the entities.

The resulting oversight system means investors – the primary consumer of proxy advisory services – are responsible for oversight of the service provider – proxy advisory firms – when there is a demonstrated economic necessity for consumers to use the service and no real alternative service provider.[4] SEC oversight and standard-setting is therefore necessary to ensure that these solicitations meet the requirements of Rule 14a-9.

The lack of effective oversight has facilitated multiple procedural and structural defects inherent in the proxy advisory firm industry, including:

1. **Procedural Shortcomings in the Proxy Report Process**: The lack of opportunity for companies to review draft and final proxy reports prior to publication to address potential errors or a lack of rigor with proxy advisory firm analyses;
2. **Conflicts of Interest**: Major conflicts of interests inherent in the proxy advisory firm business and ownership structure; and

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[1] See Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. 1A-5325; IC-33605, (Sept. 10, 2019).

[2] According to Center On Executive Compensation data of the S&P 500 from 2011 through 2018, a year-over-year change in ISS recommendation on "Say on Pay" has yielded an average percentage point change of +/- 27%

[3] External research has estimated Glass Lewis's influence at around 7%. Research by Professor David Larker at Stanford University found that among 2,008 firms in the Russell 3000, "firms that received a negative recommendation by ISS (Glass Lewis) obtained an average 68.68% (76.18%) voting support in SOP [say on pay] proposals. In contrast, firms that did not receive a negative recommendation from ISS (GL) obtained an average of 93.4% (93.7%) support in those proposals." The Larcker research is generally consistent with Center research. David F. Larcker, The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policies, Harvard Law School Forum on Corporate Governance and Financial Regulation, November 12, 2012, http://blogs.law.harvard.edu/corpgov/2012/11/12/the-economic-consequences-of-proxy-advisor-say-on-pay-voting-policies/ (last visited November 12, 2018).

[4] The extreme demands of proxy season where institutional investors vote thousands of proxies for the companies in their portfolios make it difficult for the firms utilizing proxy advisory firm services to hold the firms accountable for flagrant conflicts of interest and procedural shortcomings.

3. **Lack of Transparency**: A general lack of transparency in the reports regarding proxy advisory firm voting policies and procedures, including the reliance on opaque, non-GAAP financial metrics.

Importantly, the problems with the structural defects inherent in the proxy advisory firm industry are amplified by the immediacy in which the influence of proxy advisory firms manifests itself upon the publication of the proxy report.[5]

In recognition of the shortcomings of the proxy advisory firm status quo, the Commission introduced a set common sense reforms to the proxy advisory firm exemption to the proxy solicitation rules on November 5, 2019.

If implemented, the proposal would facilitate a much-needed re-calibration of the proxy process in a way which recognizes the economic need for proxy advisory firm services while also enhancing the credibility of the proxy process.

Specifically, if implemented, the Commission's proposal would:

1. Codify that proxy voting recommendations are solicitations and that 14a-9 liability attaches to such recommendations.
2. Allow all issuers the ability to review the draft proxy report for up to five business days depending on when the proxy statement was filed in relation to the annual meeting date.
3. Require that issuers be provided with a copy of the final report at least two business days prior to publication.
4. Require that issuers be provided with the ability to include a hyperlink to a company statement in the final report which is sent to the proxy advisors clients.
5. Require that proxy advisory firms must acknowledge the receipt of feedback to draft and final reports.

At the same time, it is equally as important to recognize what the proposal does **not** do:

1. Other than acknowledging receipt, proxy advisory firms would not be required to respond to, or engage with an issuer, over feedback received on either the draft or final proxy report.
2. Proxy advisory firms would not be required to change the underlying basis for a recommendation or any of the contents of a proxy report.
3. Place an issuer statement, analysis, viewpoint, or hyperlink alongside of or in prominence with the proxy advisor's own analyses of individual items covered within a proxy report.[6]
4. Issuers would have no new ability to influence or veto a proxy advisory firm vote recommendation.

As is discussed in detail in the letter below, the Center believes the Commission has created a balanced and well-structured proposal which addresses many defective aspects of the proxy process and proxy advisory firm system while preserving the important role the firms play within the process itself.

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[5] Center Subscribers report large portions of the proxy vote are submitted within 24-48 hours of publication of the proxy report.

[6] For example, if an issuer opposes a proxy advisory firm's recommendation on say on pay, proxy advisors are not required to include anything from the issuer alongside the specific section of the proxy report covering the say on pay vote. Only a singular hyperlink is required to be included to an issuer resource.

II. Review of the Draft and Final Proxy Reports Necessary to Ensure Investors Receive the Full Picture of Material Information

From the perspective of Chief Human Resources Officers and their Executive Compensation professional staff, the most problematic aspects of current proxy advisory firms oversight stem from serious procedural and transparency shortcomings with the proxy advisory firms' report publication process and their prohibitive engagement policies and procedures. Specifically, the lack of any reasonable access by all issuers – not just the largest issuers – to draft and final proxy reports and the inability of those issuers to adequately review both reports before publication is highly problematic.

The problems facing issuers and the wider market occur due to the extreme difficulty in engaging with proxy advisory firms during the proxy season and the immediate and near irrecoverable impact the issuance of the proxy report has on voting results.

The ability of issuers to review and provided feedback on both draft and final proxy reports prior to publication is an important step in preserving the integrity of the proxy voting process. Proxy advisory firms must prepare in-depth reports on thousands of issuers for thousands of proxy voting issues in an severely compressed time frame. Allowing issuers to *review* – not change or alter – the draft and final proxy reports helps ensure the data within the reports is properly vetted prior to its use by investors in making fiduciary voting decisions. Notably, issuers will bear the costs of vetting and reviewing the data on behalf of the proxy advisory firm.

Separate, however, from the need to review the proxy report to ensure voting recommendation data is free of errors, is the equally important need for issuers to *understand* the underlying basis for the proxy advisory firm's recommendations prior to the report's general publication.

It is well established that proxy advisory firms have philosophies on executive compensation and corporate governance issues which differ from those of issuers. These differences can result in divergent recommendations compared to management for how investors should vote on any number of corporate governance issues. Nothing should infringe on the ability of proxy advisory firms to maintain their own unique perspectives and philosophies.

As noted earlier, proxy advisory firms wield tremendous influence over proxy outcomes.[7] Most significantly, the influence manifests itself *almost immediately* during proxy season with a significant percentage of votes cast within the first 24-48 hours after publication of the final report. Due to the concentrated number of annual meetings in proxy season, proxy advisory firm reports tend to be published closer and closer to the meeting date. That provides issuers and investors with substantially less time to address concerns with a final, published report. Further, proxy advisory firms are substantially less likely to make changes or issue alerts after the fact, especially in cases where an error may have resulted in an adverse vote recommendation.

In addition, proxy advisory firms have a financial disincentive to address errors discovered in a final report. ISS has committed to clients that it will maintain a certain level of accuracy within reports. Therefore, any error that may force them to issue an alert and/or change a vote recommendation carries a potentially high cost. Most companies do not get a chance to address any errors in the report until after publication and auto-voting has begun. As such, companies are forced to fight an uphill battle to correct errors and discuss concerns with their shareholders.

The *immediate* impact of a proxy voting recommendation's publication underscores the need for the Commission's proposed changes. By allowing the review of the draft and final report, as well as the ability to include a hyperlink in the final report, the Commission's proposed changes ensure investors will

[7] According to Center On Executive Compensation data of the S&P 500 from 2011 through 2018, a year-over-year change in ISS recommendation on "Say on Pay" has yielded an average percentage point change of +/- 27%

have a full picture of the information from which they can then make an informed, *proposal-specific* voting decision and avoid the pitfalls of automatic submissions.

The proposed changes will provide a procedural opportunity for issuers to proactively address concerns, and for investment managers to make informed decisions, rather than forcing issuers into a reactionary process at a point when many of the votes have already been cast on the basis of solicitations that may fail the standards of Rule 14a-9.

The Center acknowledges these changes proposed by the Commission could require proxy advisory firms to make operational changes to ensure compliance with the new requirements of the proxy advisory firm exemption to the proxy solicitation rules. These operational changes could impose new costs on proxy advisory firms as well as increase the time needed to publish a report following the filing of an issuer's proxy statement.

Given the significant need for changes to the proxy process, the challenges of the proxy advisory firm status quo, and the anticipated effectiveness of the proposed changes, the Center believes these costs are justified, particularly if considered in the context of the costs imposed by the proxy solicitation requirements and other regulatory compliance on issuers.

The Center applauds the Commission for the balanced approach adopted in the proposal. Not only do the proposed review periods of the draft and final reports remedy a major issuer concern with the proxy process from an administrative and resource allocation perspective, but the changes allow more effective shareholder engagement by preventing errors and allowing more informed conversations.

Importantly, the review of the draft and the final proxy report only function to improve the proxy process if implemented *together*. Each review functions as a necessary half to a whole framework which, *only* if implemented *together*, effectively works to ensure the integrity of the proxy process.

A. Review of the Draft Proxy Report Fundamental to Integrity of the Proxy Voting Process

In the November 5, 2019 proposed rule, the Commission added a requirement to the proxy advisory firm exception to the proxy solicitation rule which provides for the review of the draft proxy report for all issuers. The length of time for review of the draft report depends on the filing date of the company's proxy compared to the date of the annual meeting.

Currently, the two major proxy advisory firms – ISS and Glass Lewis – each maintain distinctly inadequate policies for the review of draft proxy reports.

It is the Center's understanding that ISS makes every effort, but does not guarantee, to provide each constituent of the S&P 500 Index two business days to review the report for the annual shareholder meeting. The stated two-business day review period is the maximum period, irrespective of the number of proposals or the vote recommendations. Should ISS vote recommendations be in line with management recommendations, the review period (especially during proxy season) could be shorter or not provided at all.

ISS only provides draft proxy reports to S&P 500 issuers which have registered on its website. The draft reports are emailed to S&P 500 issuers two to four weeks before an issuer's annual meeting. Center Subscribers routinely report receiving the copy of the draft report late on a Thursday or Friday and having to return it the following Monday. Further, according to Center Subscribers, ISS often does not acknowledge receipt of the feedback and efforts to engage with the analysts are rebuffed. For final reports, ISS provides all issuers with a copy only upon *publication.* Thus, issuers are often left in the dark as to whether needed feedback has been received by ISS and incorporated into the final proxy report until after their clients have received the report.

Outside of the S&P 500, issuers do not receive copies of draft reports. ISS's internal rules on which companies are eligible for a draft has been extremely challenging for "edge" companies which have moved in and out of the S&P 500 – one year they receive the draft report – the next year they do not.

Even with this policy, however, there are other exceptions to the draft proxy report policy. For example, draft reports are not provided for any meeting where the agenda includes an M&A proposal, proxy fight, or "controversial" items such as a "Vote-No" campaign.

Comparatively, Glass Lewis does not provide a draft report to any issuer and charges $5,000 for a copy of the final report. Glass Lewis does provide issuers with a data-only version of the proxy paper prior to publication. This paper, however, does not contain any analysis or voting recommendations, but does contain the data points used by Glass Lewis to conduct the analysis. The only way to view the analyses and recommendations is to purchase the report.

More recently, Glass Lewis has created a limited forum for companies to review proxy reports and provide feedback. This is certainly a positive development. However, the limited scope of the program in terms of issuer coverage necessitates the review periods included in the proposed rule.

i. Access to Draft Report

Under the Commission's proposal, all issuers would receive copies of the draft proxy report for review. The Center fully endorses this proposal to expand the ability to access and review a draft proxy report to all issuers. As is detailed above, currently only S&P 500 companies receive copies of the draft ISS report while no issuers receive a copy of the draft Glass Lewis report.

There is no valid argument against providing all issuers with a copy of the draft proxy report. ISS, for example, already creates draft (and final) proxy reports for all issuers on which it makes voting recommendations, and thus providing them to issuers beyond the S&P 500 is feasible.

All interested stakeholders, and particularly the parties relying on the data to make fiduciary voting decisions, have a strong vested interest in the veracity and review of the data in the draft (as well as final) proxy reports. Providing all companies with the ability to review the draft proxy report is an important step to ensuring the integrity of the data within the proxy report.

Further, allowing issuers to understand the basis for the recommendations of a proxy advisory firm also helps facilitate effective engagement with shareholders and the proxy advisory firms themselves.

ii. Time Period

The Center believes the Commission has provided for a workable method for determining the length of time an issuer will receive to review the draft proxy report. Specifically, the Commission created the following framework for determining the length of time an issuer will receive to review the draft report:

Proxy Filing Date Compared to Annual Meeting Date	
More than 45 days prior to the Annual Meeting	At least five business days
Less than 45 days, but more than 25 days prior to the Annual Meeting	At least three business days
Less than 25 days prior to the Annual Meeting	No mandated review

The Center believes the proposal provides a balanced and *predictable* framework within which issuers can effectively review draft proxy reports. First and foremost, no Center Subscriber reported any plan to alter carefully designed proxy filing preparation schedules in order to fall within a specific bracket outlined in the proposed rule.

According to feedback from Center Subscribers, most issuers will receive three business days to review the draft report based on the proxy preparation schedules currently established. The key to the success of the proposal from an issuer's perspective, according to the feedback received by the Center

was the consistency and predictability of knowing that the draft report would be made eligible for review for a set period.

With the knowledge of how much time an issuer would be allocated to review the draft report, issuers will be able to effectively allocate limited resources to maximize the review period window. Thus, the Commission's framework effectively addresses a key concern executive compensation practitioners and human resources executives have with the proxy advisory firm status quo.

The Commission's proposal addresses a key issuer concern while also accommodating proxy advisory firm business processes. We acknowledge that proxy season presents an operational challenge for proxy advisory firms. They must provide analyses and reports on a substantial proportion of US-listed companies and thousands of management and shareholder proposals on corporate governance, executive compensation, environmental and social concerns, as well as capital structure, economic proposals such as mergers, and proxy contests.

Center Subscribers routinely report being completely unable to engage with proxy advisory firms during the proxy season due to the extreme business demands place on proxy advisory firms. Providing a set time period for review, as proposed, allows issuers – which understand they are unlikely to engage with proxy advisors in the moment – to thoroughly review the draft report and prepare for potential shareholder engagement.

B. Final Report Review Ensures Integrity of the Proxy Voting Process

Proxy advisory firm proxy reports can have a significant influence over the voting results of corporate proxy votes. These outcomes can have a major impact on issuers and their employees, various stakeholders, and shareholders – both those which subscribe and do not subscribe to proxy advisory firm services – as well as the overall market in general.

The influence and impact proxy advisory firm reports – particularly those from ISS and Glass Lewis – have on proxy votes is *immediate*. Within 24 hours of publication of the report, a statistically significant percentage of proxy votes are cast by investors – often automatically – based on the proxy advisory firm recommendations. Center On Executive Compensation data shows that a year-over-year change in ISS recommendation on a shareholder say on pay vote results in an average change in shareholder support of 20-27% percentage points.

Given the immediate and significant impact of the publication of the proxy report, ensuring the report is correct and properly vetted is vital to the overall proxy voting process. Investment managers need to be aware of the underlying basis for conclusions in the proxy report and take them into consideration in their voting decisions.

The importance of the final report review amplified by the financial disincentive that proxy advisory firms – and specifically ISS – may have in issuing corrections in the case that a report is incorrect with errors or inaccuracies. ISS maintains commitments to accuracy in the service agreements with clients. As such, if a certain number of vote recommendations are changed due to errors, ISS may have a contractual, financial obligation to clients. Further, an error resulting in a vote recommendation change effectively requires ISS to re-evaluate the proposal in question, producing a new written analysis. From a workflow perspective, given the extremely tight timelines during proxy season, there is a substantial disincentive to admit errors, correct reports, and publish alerts. Therefore, if a company finds an error post-publication, engaging with ISS to change an error is an uphill battle.

Unfortunately, the current proxy advisory firm approach does not allow for any review of a final proxy report prior to its publication or recognition of the limitations of the proxy advisor analysis as the sole basis of voting decisions.

The Commission has recognized the need for change to this element of the proxy advisory firm status quo pursuant to the November 5th proposal will require proxy advisory firms to provide to all issuers a "final notice of voting advice". According to the proposal, the "final notice" must:

- Be provided at least two business days prior to the proxy report's dissemination to clients even if an issuer did not provide feedback during the review of the draft report.
- Include copy of the final proxy report which will be sent to clients/investors that includes any revisions to the proxy report made as a result of the review and feedback period.
- Provide issuers with the ability to provide a single hyperlink to a company statement in the final report which is sent to investor clients.

The Center fully endorses the Commission's proposal of the "final notice of voting advice" which must be provided to issuers. Two business days is adequate time for an issuer to review the changes included in the final proxy report compared to the draft report and to evaluate the extent to which any feedback given during the draft review process was incorporated into the final report. A key aspect of this is the ability for issuers to have an *expectation* of the time which they will have to review the final report to allow effective allocation of resources during a busy proxy season.

The combination of the review of the draft report, notice of the final report prior to publication and the ability to provide a hyperlink provide the needed tools to ensure the contents of the proxy report are fully vetted prior to use by investors in fiduciary voting decisions.

Furthermore, the final notice better allows investors to receive a full perspective of viewpoints on the proxy voting issue. Given the reliance of investors on proxy reports and feedback that proxy reports provide a quick and accessible way to evaluate a corporate proxy proposal (considering the length proxy statements), the inclusion of a link to feedback provides much needed notice of potentially contrasting viewpoints over a proxy issue.

The Center does not believe proxy advisory firms should be required to alter any philosophical approaches to the evaluation of proxy voting issues, including executive compensation, or stakeholder concerns such as environmental, social, or governance issues. Unsurprisingly, the Center and our Subscribers do *disagree* with some of the positions adopted by proxy advisory firms.

By including a link, investors will be better informed about contrasting viewpoints over a proxy vote issue in the medium many investors may heavily – or exclusively – rely upon when casting a vote as a fiduciary during a very small-time window during proxy season.

III. Proxy Advisory Firm Conflict of Interest Disclosures Are Necessary to the Integrity of the Proxy Voting Process

Proxy Advisory Firm conflicts of interest are well documented.[8] Unfortunately, despite the egregious nature of some of these conflicts, there is an absence of adequate disclosure provided by proxy advisory firms. What disclosure is provided is typically boilerplate and lacks needed information that issuers and investors need to appropriately evaluate the context of a proxy advisor's recommendations.

The most egregious conflict of interest in the proxy process involves ISS, the largest and most influential proxy advisory firm. ISS has two lines of business. The first, ISS Research, provides proxy voting recommendations and analyses to institutional investor clients, including clients that are publicly traded. The second, ISS Corporate Solutions, provides consulting services to corporate issuers on the

[8] See Subcommittee on Capital Markets and Government Sponsored Enterprises (Committee on Financial Services) Hearing: "Legislative Proposals to Enhance Capital Formation, Transparency, and Regulatory Accountability", available at https://www.youtube.com/watch?v=NIVhLQMOj24&feature=youtu.be&t=5404 (last visited Jan. 23, 2020)

same proxy voting items, corporate governance structure, and executive compensation on which ISS Research makes recommendations.

ISS is essentially playing both sides of the ball here. *Any change or addition* to the approach utilized by ISS Research in how it evaluates proxies has the natural and unavoidable consequence of driving business to its consulting services as issuers strive to make sure they follow ISS Research's new or evolving perspectives. The conflict is inherent with having this business structure and exists regardless of whether ISS has an effective firewall preventing the Research business from communicating with the Consulting business.

The Center fully supports the Commission's proposed disclosure of proxy advisory firm conflicts of interest. The Center believes any required disclosure of proxy advisory firms should be designed to accomplish three important objectives:

1. Disclosure Must Be Public: The public nature of the disclosure will allow all interested and impacted stakeholders – not just the narrow population of proxy advisory firm clients – to evaluate proxy advisory firm conflicts of interest;
2. Disclosure Must be Specific: The disclosure cannot be boilerplate and must address the unique scenario presented by the conflict; and
3. Disclosure Must Be Principles-Based: The disclosure recognizes the variance in proxy advisory firm business practices and is structured in a manner which does not reveal any proprietary information nor act as an industry barrier to entry.

By aiming to satisfy the three objectives above, the Commission would create an effective and flexible disclosure regime which effectively allows the disclosure of existing conflicts while also providing an adaptable disclosure template for future conflicts of interest which are not currently envisioned.

A. The Commission Should Include Examples of *per se* Conflicts of Interest in the Final Rule

In the proposed rule, the Commission establishes the materiality standard as the baseline test for determining whether disclosure of a proxy advisory firm conflict of interest is warranted. The Center supports this approach and urges the Commission to provide examples of material conflicts of interest to assist proxy advisors in recognizing where disclosure is necessary. The examples should include illustrations of compliant and complete disclosures.

The Center believes the following three situations should be specifically enumerated by the Commission as rising to the materiality standard:

1. If a proxy advisory firm provides consulting services to an issuer while also providing voting research and recommendation on that same issuer.
2. If a proxy advisory firm provides consulting services to a shareholder proponent or affiliate on a shareholder proposal while also providing voting research and recommendations on that same shareholder proposal.
3. If a proxy advisory firm is owned by an investor group which is advocating for a position on a proxy vote or other corporate governance issue or practice which is subject to research and recommendations provided by the proxy advisory firm to investor clients.

As for the content of the disclosure, the SEC should specifically require that an acceptable disclosure would:

1. Identify the conflicted parties;

2. Identify the nature and subject matter of the conflict (*i.e.*, executive compensation consulting while also providing a voting recommendation on say on pay); and

3. Describe steps taken by the proxy advisory firm to reduce any actual or perceived conflict of interest.

By identifying scenarios which would be considered material and requiring the inclusion of the three elements above, the SEC creates an effective and flexible disclosure regime which allows the disclosure of existing conflicts while also providing an adaptable disclosure template for future conflicts of interest which are not currently envisioned.

Furthermore, the disclosures allow the institutional investors and advisors to adequately evaluate the proxy advisory firms to determine independence in compliance with their required fiduciary responsibilities. The completeness of the above framework also provides all interested stakeholders the ability to evaluate proxy advisory conflicts in the context of the voting recommendations they issue.

Shareholder Resubmission Thresholds

The Center would like to also express our strong support for the updates to the shareholder resubmission thresholds. The SEC has recognized the need to update the current resubmission thresholds which have allowed proposals rejected by nearly 90% of investors to continuously appear on the ballot. The Center strongly supports the Commission's proposal to update the resubmission thresholds from their current 3%/6%/10% levels to a more reasonable 6%/15%/25% levels of support.

The Center believes that the updated proposals will do nothing to restrain or restrict shareholder proposals which have legitimate levels of shareholder support. At the same time, the changes will eliminate proposals which sit on the proxy year after year with no real chance of adoption.

Conclusion

The Center appreciates this opportunity to provide feedback on the Commission's ongoing effort to address the multifaceted issues surrounding proxy advisory firms. If you have any questions about the Center's comments, please do not hesitate to contact me at [redacted].

Sincerely,

Henry Eickelberg
Chief Operating Officer

cc: Securities and Exchange Commission:

Hon. Jay Clayton, Chair
Hon. Hester Peirce, Commissioner
Hon. Elad Roisman, Commissioner
Hon. Robert Jackson, Commissioner
Hon. Allison Herren Lee

Appendix A

Center On Executive Compensation

November 12, 2018

VIA Electronic Delivery

Mr. Brett J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Comments on the SEC Roundtable on Proxy Process Issues – Proxy Advisory Firms and Shareholder Proposals

Dear Mr. Fields:

The Center On Executive Compensation ("Center") is pleased to submit comments to the Securities and Exchange Commission ("Commission") providing its perspective on proxy process issues, specifically on proxy advisory firms and shareholder proposals, in advance of the November 15 Proxy Process Roundtable. Since the introduction of mandatory "Say on Pay" voting in 2010, shareholder engagement, participation, and interaction with corporate governance and management has evolved dramatically.[1] The existing regulatory framework is ill-equipped to address these changes and to accommodate further evolution driven by technology, new sources of capital, and the growth in activism.

Given the disconnects due to the absence of an appropriately tailored regulatory and disclosure scheme within the current proxy process, the Center believes two specific areas warrant the attention of the Securities and Exchange Commission:

1. The Role and Influence of Proxy Advisory Firms; and
2. The Shareholder Proposal Process.

The Center's recommendations for the Commission on each topic provide market-driven solutions which remediate the concerns without the creation of an onerous oversight regime that negatively impacts shareholder rights or act as an industry barrier of entry. Further, the Center's recommendations recognize the important role both proxy advisory firms and shareholder proposals play within the proxy process.

The Center brings a unique issuer perspective to the discussion of the proxy process and proxy advisory firms. The Center provides extensive executive compensation and corporate governance public policy insight to the top human resources and executive compensation professionals at the Center's more than 140 subscribing companies. The commentary in this letter reflects the views and concerns of the human resources and executive compensation professionals who interact with proxy advisory firms as part of their profession as executive compensation and human resources executives at major U.S. public companies.

[1] "Since the 2010 concept release, we have seen a dramatic increase in the number of U.S. companies reporting shareholder engagement, with 72% of S&P 500 companies reporting engagement with shareholders in 2017, compared to just 6% in 2010." Statement Announcing SEC Staff Roundtable on the Proxy Process, available at https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process#_ftn4 (last visited August 1, 2018).

I. Executive Summary

A. Proxy Advisory Firms

Proxy Advisory Firms play an important role in the proxy process by providing proxy voting recommendations to institutional investors for the thousands of management and shareholder proposals for the hundreds or thousands of companies within their portfolios. When voting on proxy proposals, institutional investors have a fiduciary obligation to vote in the best interest of their shareholders.[2]

According to the federal securities laws, this fiduciary obligation applies when utilizing proxy advisory firm services for voting recommendations and analyses.[3] As a result, an investment advisor seeking to utilize proxy advisory firm voting recommendations and analyses to fulfill fiduciary obligations must ascertain that "the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party."[4]

For years, this commentary provided a considerable degree of fiduciary "cover" to the investment managers which chose to follow the voting recommendations of proxy advisory firms and reinforced the value of using such firms. The practice was reinforced by two SEC Staff "No Action" letters, the Egan-Jones Proxy Services letter of May 2004 and the subsequent ISS letter. Notably, these letters were revoked by the Commission in Mid-September.[5] The letters effectively permitted current proxy advisory firm practices to develop, including significant conflicts of interest and severe procedural shortcomings which injure key stakeholders.

Proxy advisory firms are subject to the proxy solicitation rules.[6] However, the firms are provided an exemption from the rules.[7] Thus, primary oversight of proxy advisory firms is achieved indirectly through the fiduciary duties of the investment advisors and institutional investors utilizing proxy advisory firm services. As a result, proxy advisory firm accountability exists only to the extent the customers of proxy advisory firms collectively hold them to high standards.[8]

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[2] See Sec. Exch. Comm'n, Final Rule: Proxy Voting by Investment Advisers, Advisers Act Release No. 1A-2106, 17 C.F.R. § 275 (Jan. 31, 2003).
[3] *Id*.
[4] *Id*.
[5] The Egan-Jones letter effectively gave investors a "safe harbor" in relying on proxy advisory firm voting recommendations without running afoul of the federal securities laws. Specifically, the letter said that an investor that relies on an "independent third party" in determining proxy votes will be viewed by the SEC to have upheld their fiduciary duty to vote proxies in their clients' best interest if the third party is "free from influence or incentive to make recommendations other than in the advisor's best interest." The ISS letter facilitated ISS's consulting services business by stating proxy advisory firms can demonstrate independence based on an evaluation of the proxy advisory firm's "conflict procedures" rather than a case-by-case analysis of individual conflicts. ISS provides "independent" proxy voting recommendations on a company to investors while often providing the company with consulting services on how to get a better ISS voting recommendation. *See* Egan-Jones Proxy Services, SEC Staff Letter (May 27, 2004) ("Egan-Jones") and Institutional Shareholder Services, Inc., SEC Staff Letter (Sept. 15, 2004) ("ISS").
[6] See Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, available at https://www.sec.gov/interps/legal/cfslb20.htm (last visited November 8, 2018)
[7] *Id*.
[8] ISS is a Registered Investment Advisor under the Investment Advisers Act. Despite claims to the contrary, this regulatory scheme does not provide the correct framework for oversight given ISS's business model and the fundamental differences between ISS and a typical investment adviser registered under the Advisers Act.

The concerns are compounded by extreme industry consolidation whereby two firms control roughly 97% of the market share.[9] The necessary reliance on the two firms controlling such market share by institutional investors which cast tens of thousands of proxy votes during proxy season has created a scenario where the firms, and particularly ISS, have become *de facto* standard setters for corporate governance and executive compensation practices, which is reinforced by the absence of an appropriate regulatory framework.

Unfortunately, the extreme demands of proxy season make it difficult for the firms utilizing proxy advisory firm services to hold the firms accountable for flagrant conflicts of interest and procedural shortcomings. Thus, the existing indirect regulation of proxy advisory firms is ineffective.

Regardless, and perhaps more concerning, is the fact that multiple procedural and structural defects inherent in the proxy advisory firm industry would significantly impair the ability of even the most ardent institutional investor or investment advisor from effectively holding proxy advisory firms accountable. The main issues within the proxy advisory industry which stem from the lack of oversight and accountability are:

1. **Conflicts of Interest**: Major conflicts of interests inherent in the proxy advisory firm business and ownership structure;
2. **Procedural Shortcomings in the Proxy Report Process**: The lack of opportunity for companies to provide reasonable input in the proxy recommendation process, including addressing a lack of rigor and accuracy with proxy advisory firm analyses; and
3. **Lack of Transparency**: A general lack of transparency surrounding proxy advisory firm voting policies and procedures.

In this letter, the Center outlines practical steps for the Commission to consider which we believe will recalibrate the function proxy advisory firms play within the proxy process while recognizing the importance of their role. If implemented, the Center's recommendations would achieve the following important objectives:

1. Recognize the economic necessity for proxy advisory firms within the proxy process while not creating additional barriers to entry;
2. Permit market participants to effectively evaluate and mediate conflicts of interest within the proxy advisory firm industry – without the need for constant SEC oversight;
3. Enhance the ability of institutional investors to fulfill fiduciary responsibilities when voting their proxies;
4. Provide a reasonable voice for interested stakeholder groups currently excluded from the proxy advisory firm process.

The following briefly summarizes the Center's proposed solutions for addressing the problems with the proxy advisory firm industry explained in detail in our comments. For recommendations 1, 2, 4, and 5, the Center urges the SEC to add each element as a requirement to qualify for the exemption from the federal proxy solicitation rules under Exchange Act Rule 14a-2(b)(3). For recommendation 3, the Center urges the SEC to add the element to a current or new institutional investor disclosure requirement pertaining to proxy voting results.

1. **Mandatory Disclosure of Conflicts of Interest**. The SEC should require proxy advisory firms to provide detailed conflicts of interest disclosures. A wide array of stakeholders, including the investment managers utilizing proxy advisory firms, as well as other investors

[9] James K. Glassman and J.W. Verret, How to Fix Our Broken Advisory System, Mercatus Center (2013), http://mercatus.org/publication/how-fix-our-broken-proxy-advisory-system

and issuers, are impacted by proxy advisory firm recommendations and conflicts of interest. Individual conflict of interest disclosures should be required to be public in addition to disclosures within the proxy report materials presented to clients. A proper disclosure would include the following elements:

a. Nature of Conflict and Subject Matter;

b. Involved Parties;

c. Monetary Compensation Received; and

d. Whether Voting Recommendations Differ from Conflicted Party;

2. **The "Five-Day Rule"**: Currently, issuers are not provided with adequate opportunities to review draft and final proxy reports. The SEC should mandate that all issuers must receive a draft of the proxy report to be provided on the issuer by a proxy advisory firm to its clients. Additionally, issuers must have five business days to review the draft report. Subsequently, upon the finalization of the report by the proxy advisory firm, the final version of the report must be given to the company followed by a five-day blackout period before the report can be disseminated.

3. **Custom Voting Policy Disclosure**: Many institutional investors and hedge fund portfolio managers maintain active corporate governance teams which utilize proxy advisory firm analyses and recommendations as a part of their evaluation of how to vote the proxy. There are, however, other investors which rely upon proxy advisory firm recommendations without any review or further consideration. Investors which utilize proxy advisory firms should be required to disclose:

   a. Whether the institutional investor and their investment advisor utilize a customized voting policy when engaging proxy advisory firms for proxy voting recommendations and analyses;

   b. If a customized voting policy is used, a *brief* explanation of the proxy issues covered by the policy; and

   c. The percentage frequency in which the investor voted in unison with the proxy advisory firm on each issue covered by the customized voting policy.

4. **Methodological Reconciliation**: Currently, proxy advisory firms utilize proprietary valuation methodologies for executive compensation in their proxy reports. The SEC should require proxy advisory firms to "show their math" and provide the analysis utilizing the issuer's valuations to allow investors to view a true side-by-side comparison of the differences in assumptions.

5. **Rolling Fiscal Year Policy Implementation**: Proxy advisory firms update many of the proxy voting policies and underlying methodologies on an annual basis. However, issuers often operate, by necessity, on different timelines. This can create a disconnect between an issuer implementing changes to compensation and governance programs before proxy firm policy changes are announced and ensuring alignment with changes to the "current" proxy advisory firm policies. The SEC should mandate a rolling fiscal year approach to proxy advisory firm policy changes whereby finalized policy changes will not apply to annual meetings which take place before the start of the *next* fiscal-year. Thus, a policy change completed in December 2018 would go into effect January 1, 2020 after the completion of the fiscal year waiting period.

B. Shareholder Proposals

The shareholder proposal framework governed by Exchange Act Rule 14a-8 serves as an important element of the proxy process by providing a shareholder(s) with a tool to engage with an issuer on matters important to the shareholder(s). The input received through the shareholder proposal process can assist an issuer's management and board with further enhancing shareholder value.

While shareholder proposals serve an important purpose, necessary limitations exist surrounding the ability of proponents to submit and re-submit proposals. Additionally, given the fiduciary responsibilities of an issuer's officers and board of directors to guide and run the business, the subject-matter scope of shareholder proposals must also be limited. The federal securities laws recognize the need for appropriate limitations which are outlined in Exchange Act Rule 14a-8.

Over the past several years, the nature and use of shareholder proposals has seen a shift in focus with social and environmental shareholder proposals garnering significant attention. Additionally, shareholder proposals on other significant areas of corporate management, like preferring buybacks as a method to return cash to shareholders, have also become more and more common.

Under the current framework, however, micro-minority shareholders which own less than one-ten-thousandth of a percent of an issuer can submit a shareholder proposal annually in perpetuity despite the fact the proposal is rejected by nearly 90% of fellow shareholders. As noted above, the ability to submit shareholder proposals is undoubtedly an important shareholder right. However, the endless re-submission of proposals which are rejected by significant majorities is simply not good policy.

The Center believes the SEC should make two needed updates to Rule 14a-8 to modernize the shareholder proposal framework to reflect the current landscape of the use of shareholder proposals. Taken together, the Center's Solutions accomplish three primary objectives:

1. Preserve the ability of shareholders to submit proposals to management;
2. Preserve the ability of shareholders and issuers to negotiate on key issues brought up by shareholder proposals; and
3. Emphasize the importance of shareholder proposals by removing frivolous proposals from the proxy ballot.

The following briefly summarizes the Center's recommendations on the shareholder proposal aspect of the proxy process:

1. **Update the Shareholder Proposal Resubmission Thresholds**: The SEC should update the shareholder resubmission thresholds from the current 3%/6%/10% standards to reflect the 6%/15%/30% standards enumerated below:
    a. If voted on once in the last five years – currently at 3% - Proposed to change to 6%;
    b. If voted on twice in the last five years – currently at 6% - Proposed to change to 15%; and
    c. If voted on three or more times in the last five years – currently at 10% - Proposed to change to 30%.
2. **Impose a Five-Vote Limit on Unsuccessful Shareholder Proposals**: The SEC should allow for the exclusion of a shareholder proposal which has been voted on by an issuer's shareholders five consecutive times without achieving majority support.

II. Proxy Advisory Firms

Proxy advisory firms fill an important role for institutional investors. As the share of institutional investor ownership has grown from 46% in 1987 to over 70% today, the volume of proxy votes which investors are responsible for casting has grown into the billions. To assist them in fulfilling their fiduciary duty to vote proxies in the best interests of their clients, most institutional investors rely on the services of Institutional Shareholder Services ("ISS"), the largest proxy advisory firm, or Glass Lewis & Co., the other major proxy advisory firm. Together, these firms cover about 97 percent of the U.S. market for proxy advisory firm services.

For institutional investors, proxy advisory firm services represent the only cost-effective manner for voting proxies while also striving to fulfill the required fiduciary standards. Yet, the financial necessity for proxy advisory firm services gives ISS and Glass Lewis tremendous influence over executive compensation and corporate governance practices.

According to Center On Executive Compensation data of the S&P 500 from 2011 through 2018, a year-over-year change in ISS recommendation on "Say on Pay" has yielded an average percentage point change of +/- 27%.[10] External research has estimated Glass Lewis's influence at around 7%.[11]

Similarly, ISS's support of a shareholder initiative pertaining to compensation or governance as part of their standard policies can enhance the success of the shareholder proposals. Further, ISS's support of various executive compensation plan metrics and structures (*i.e.*, the use of Total Shareholder Return as a compensation metric or modifier) can cause widespread adoption of the element or structure by issuers seeking to ensure ongoing compliance with ISS's expectations.

As noted above, primary oversight of proxy advisory firms is applied indirectly through the fiduciary duties of the investors and investment advisors which utilize their services. Conceptually, the "indirect" regulation of proxy advisory firms functions by requiring the investors and advisors which utilize proxy advisory firm services to ascertain "the vote was not a product of a conflict of interest if [they] voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party."[12]

By taking these steps – which presumably hold the proxy advisory firms accountable and to high standards – can the investor or advisor uphold their own fiduciary responsibilities. In 2014, the SEC Staff issued guidance reinforcing the responsibilities of investors and advisors which utilize proxy advisory firm services.[13] Additionally, the Guidance also reaffirmed that proxy advisory firms were subject to the federal proxy solicitation rules but can fall under an exemption from those rules.[14]

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[10] Center On Executive Compensation Data.

[11] Research by Professor David Larker at Stanford University found that among 2,008 firms in the Russell 3000, "firms that received a negative recommendation by ISS (Glass Lewis) obtained an average 68.68% (76.18%) voting support in SOP proposals. In contrast, firms that did not receive a negative recommendation from ISS (GL) obtained an average of 93.4% (93.7%) support in those proposals." The Larcker research is generally consistent with Center research. David F. Larcker, The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policies, Harvard Law School Forum on Corporate Governance and Financial Regulation, November 12, 2012, http://blogs.law.harvard.edu/corpgov/2012/11/12/the-economic-consequences-of-proxy-advisor-say-on-pay-voting-policies/ (last visited November 12, 2018).

[12] See Sec. Exch. Comm'n, Final Rule: Proxy Voting by Investment Advisers, Advisers Act Release No. 1A-2106, 17 C.F.R. § 275 (Jan. 31, 2003).

[13] See Staff Legal Bulletin No. 20 (IM/CF), "Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms", available at https://www.sec.gov/interps/legal/cfslb20.htm (last visited 10/30/2018)

[14] *Id*.

Unfortunately, the indirect oversight of proxy advisory firms through the fiduciary duties of investment institutions and their advisors fails to prevent the abuses the federal securities laws seek to prevent.

Proxy voting has changed dramatically over the last fifteen years with proxy votes regarding an issuer's operational, strategic, and governance strategy growing in frequency and importance. The closed nature of the "indirect" oversight relationship--which exists only between proxy advisory firms and the investor or advisor which utilizes their services--excludes other important stakeholders. These include issuers and their shareholders as well as other investors – *e.g.* retail investors – who are impacted but without access to proxy advisory firm reports and analyses. Additionally, proxy advisory firm recommendations impact market practices by influencing proxy votes – including important governance policies and director elections.

Much more troubling, however, is the fact that the extreme demands of proxy season, combined with the closed, two-party nature of the "indirect" oversight scheme, make it extremely difficult for the investors and advisors which utilize proxy advisory firm services to hold proxy advisory firms accountable for blatant conflicts of interest and very concerning procedural shortcomings.

Tailored additional regulatory action from the Securities and Exchange Commission, as proposed by the Center in the following sections, would effectively alleviate the most egregious of the concerns presented by the proxy advisory firm status quo. Additionally, the Center's recommendations provide a solution driven by market participants by "opening" the "closed" nature of the current indirect oversight regime.

A. Proxy Advisory Firm Conflicts of Interest Must Be Addressed Through Mandatory Disclosure

Proxy advisors are currently afforded a considerable degree of deference under SEC interpretations by being superficially designated as "independent" of the investment institutions that use their services by those same investment advisors. Yet proxy advisory firms have significant conflicts of interest in the services they provide and in how they are structured. These conflicts of interest are well documented.[15]

The most egregious conflict of interest in the proxy process involves ISS, the largest and most influential proxy advisory firm. ISS has two lines of business. The first, ISS Research, provides proxy voting recommendations and analyses. The second, ISS Corporate Solutions, provides consulting services to the same issuers and shareholder proponents whose proxies are evaluated by ISS Research. The dual arrangement allows ISS to drive consulting business based on the policies adopted by the research business.

Issuers often feel compelled to purchase consulting services from ISS Corporate Solutions. The pressure derives from the significant influence ISS Research has over shareholder voting outcomes. This is especially the case for company equity plan shareholder votes and advisory votes on executive compensation.

Center Subscribers universally report the sole reason for purchasing consulting services from ISS Corporate Solutions is due to ISS Research's influence over shareholder votes. Without ISS Research's ability to influence shareholder votes, it is unlikely many companies would purchase services from ISS Corporate Solutions. In other words, Center Subscribers find no value in ISS Corporate Solution's

[15] Proxy Advisory Firm conflicts of interest have been the subject of two reports by the federal government's auditing arm, the U.S. Government Accountability Office (GAO). See U.S. Gov't Accountability Office, Corporate Shareholder Meetings: Issues Relating to Proxy Advisory Firms That Advise Institutional Investors on Proxy Voting, GAO-07-765; and U.S. Gov't Accountability Office, Corporate Shareholder Meetings: Proxy Advisory Firms' Role in Voting and Corporate Governance Practices, GAO-17-47.

consulting services outside of the ability to assess the likelihood of securing a favorable voting recommendation from ISS Research.

ISS maintains that an effective firewall exists between ISS Research and ISS Corporate Solutions, a wholly-owned subsidiary. The experiences of Center Subscribers, however, bring the effectiveness of the firewall into question. One example occurred in September of 2013 when ISS Corporate Solutions sent an email to Motorola Solutions, referencing the fact that in the spring of 2013, when the research side of ISS recommended its clients vote against Motorola's say on pay vote (in its non-custom voting recommendation), Motorola's say on pay resolution received the support of just above 68% of its shareholders. The email said that ISS Research would be subjecting Motorola to a higher level of scrutiny in 2014 and solicited a meeting with the ISS Corporate Solutions staff.

A call was set up, during which the ISS Corporate Solutions representative referenced very high success rates (over 90%) in say on pay votes for companies that engaged ISS Corporate Solutions after receiving a low vote. The exchange left the impression that by engaging ISS Corporate Services, Motorola Solutions would receive advice and information unavailable elsewhere and that it would give the company an advantage when ISS Research analyzed its 2014 proxy.[16]

When confronted with the example at the SEC's December 2013 Proxy Advisory Firm Roundtable, ISS President Gary Retelny said "I'm disappointed they used those words," denying that there was any breach of the firewall, but acknowledging that the representative was supposed to "drum up business."[17] The email exchange and Mr. Retenly's statement about the representative trying to "drum up business" succinctly demonstrates how ISS Research's business model is used to generate revenue for ISS Corporate Solutions and summarizes why ISS's firewall fails in practice.

Perhaps more troubling, however, some problematic aspects of the arrangement cannot be prevented by a firewall. For example, ISS Research has an incentive to frequently change policy positions on proxy voting issues to drive business to ISS Corporate Solutions. Notably, even if ISS Research policy changes are not done with the intent of creating more consulting business for ISS Corporate Solutions, the practical effect is the same. Given ISS's influence, a change in policy at ISS Research creates a market need for ISS Corporate Solutions consulting services as issuers work to ensure their policies are compliant with ISS Research's updated policies.

An example of this troubling arrangement occurred in the Spring of 2018 when ISS purchased EVA Dimensions LLC, "a business intelligence firm that measures and values corporate performance based on the Economic Value Added (EVA) framework". According to ISS's press release announcing the purchase, the "acquisition will allow ISS to provide our clients a cutting-edge holistic means of assessing and defining performance of their portfolio companies."[18] Subsequently in the 2018 ISS Policy Survey, ISS Research asked a question about replacing the Financial Performance Assessment test in the pay-for-performance analysis with an EVA-based evaluation.[19] EVA is not a widely used or readily determined and disclosed metric, and the potential for its inclusion among ISS Research's analysis would have the

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[16] The full description of the exchange is in Appendix A.

[17] See Transcript of the Securities and Exchange Commission's Proxy Advisory Firm Roundtable Section 0123 – 0124 available at https://www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt (Last visited November 12, 2018)

[18] See ISS Announces Acquisition of EVA Dimensions, available at https://www.issgovernance.com/iss-announces-acquisition-of-eva-dimensions/ (Last visited November 12, 2018)

[19] According to the results of the survey, less than a quarter of investors (ISS's clients) endorsed the use of EVA. It remains to be seen whether ISS will incorporate the metric or not, but if they do, it is clearly being done for business reasons, not due to client requests.

impact of driving issuers to ISS Corporate Solutions as they work to see if their compensation plans pass the test's new parameters.

Also problematic is ISS's practice of offering consulting services to shareholder proponents on shareholder proposals which are later evaluated by ISS Research. The blatant conflict at best creates a question of the ability of ISS Research to objectively evaluate the proposal subject to the consulting services offered by ISS Corporate Solutions. At its worst, the scheme provides an example of a pay-to-win arrangement which has no place in the federal securities laws.

In an example of another conflict, Glass, Lewis & Co. (the second largest advisor) is owned by the $170 billion Ontario Teachers' Pension Plan Board and the Alberta Investment Management Group both of which engage in public and private equity investing in corporations on which Glass Lewis makes recommendations.[20] Although Glass Lewis states that it will add a note to the research report of any company in which the Ontario Teachers' Pension Plan has a significant stake, the lack of transparency in the Glass Lewis model raises important conflict of interest concerns. Specifically, without adequate public disclosure, including the ability of issuers to review draft and final proxy reports by Glass Lewis, there is no way to evaluate the firm's conflicts of interest.

i. The SEC Should Require Specific, Public Disclosures of Conflicts of Interest in Proxy Reports and on a Public Website

The most complete solution to the conflicts of interest described above would be for the SEC to prohibit the conflicts outright. This would require ISS to spin-off ISS Corporate Solutions into a separate company while also requiring the Ontario Teachers' Pension and Alberta Investment Management Group to sell their stake in Glass Lewis. Only through these actions can the conflicts of interest plaguing the proxy advisory firm industry be completely alleviated.

Short of these actions, however, disclosures provide an avenue to address the concerns with rampant conflicts of interest in the proxy advisory firm status quo. Disclosure serves as the cornerstone of the federal securities laws. The disclosure system is founded on the concept that knowledge of all material information about an investment allows informed investment decisions. In the context of the fiduciary responsibilities of investment advisors and institutional investors casting proxy votes, appropriate disclosures by proxy advisory firms provide needed information to allow informed fiduciary decision-making.

Additionally, proxy advisory firm voting recommendations have an impact on a wide group of stakeholders as well as the market generally by virtue of the influence on shareholder voting results – not just the investor and advisor clients purchasing ISS services. Thus, in addition to proxy advisory firm clients, the public has a vested interest in knowing proxy advisory firm conflicts of interest.

Currently, proxy advisory firm disclosures are woefully inadequate. ISS's conflict of interest "disclosures" are boilerplate and provide information only on conflict of interest *policies* and not on individual conflicts of interest. As noted, Glass Lewis states that it will add a note to the research report of any company in which the Ontario Teachers' Pension Plan has a significant stake. This disclosure, however, does not provide any insight as to the conflicts resulting in the ownership of Glass Lewis by two major pension funds.

More problematic is that proxy advisory firm disclosures are "closed" in nature, meaning disclosure are only made to the clients of proxy advisory firms and are unknown to other investors, impacted stakeholder groups, and the market generally. As detailed above, the extreme demands of proxy season and the need to be economically efficient can create a disincentive for the clients of proxy advisory firms

[20] See http://www.glasslewis.com/conflict-of-interest/

to take conflicts of interest seriously and to hold proxy advisory firms accountable for conflicts and other process and transparency shortcomings.

Recommendation: To address the rampant conflicts of interest present in the proxy advisory firm industry, the Center recommends the SEC require proxy advisory firms to provide thorough and public conflicts of interest disclosures to be able to be considered "independent" under Advisers Act Release No. 1A-2106.[21] Additionally, the disclosures should be required in order for proxy advisors to qualify for the exemption from the federal proxy solicitation rules under Exchange Act Rule 14a-2(b)(3). The disclosure accomplishes three objectives:

1. The public nature of the disclosure will allow all interested and impacted stakeholders – not just the narrow population of proxy advisory firm clients – to evaluate proxy advisory firm conflicts of interest;
2. The market-driven nature of the disclosure requirement does not require SEC oversight beyond the steps needed to implement the requirement; and
3. The disclosure recognizes the variance in proxy advisory firm business practices and is structured in a manner which does not reveal any proprietary information nor act as an industry barrier to entry.

The elements of the disclosure are as follows:

- Disclosure Location: Proxy advisory firm conflict of interest disclosures should be required in two separate locations – (1) the proxy report and (2) on a public website hosted by the proxy advisory firm. The dual locations of the disclosure ensure all interested and impacted stakeholders have access to the information.
    - Proxy Report: Within the proxy report, the disclosure would be required in two separate places. On the first page or on a cover page, the proxy advisory firm would be required to provide a disclosure. In addition, if the disclosure concerns an individual management or shareholder proposal, a second disclosure would be required at the beginning of the analyses on the conflicted proxy proposal. For example, if a company sought consulting services from ISS on executive compensation, ISS would be required to provide the appropriate disclosure on the first page or cover page and then at the beginning of the say on pay recommendation analyses.
    - Public Website: To address the shortcomings of the "closed" system whereby proxy advisory firm conflicts are only disclosed to clients which lack an incentive to hold proxy advisors accountable, the new disclosure regime would require conflicts of interest to be disclosed publicly on a website hosted by the proxy advisory firm. This would allow all interested stakeholder groups and the market generally to have access to the material information.
- Nature of Conflict and Subject Matter: Proxy advisory firms would also be required to briefly describe the nature of the conflict of interest as well as the subject matter. For example, suppose a proxy advisory firm provides consulting services to a shareholder proponent on a specific shareholder proposal on which the proxy advisor issues a recommendation. The required disclosure could state "Proxy Advisory Firm provided

[21] See Sec. Exch. Comm'n, Final Rule: Proxy Voting by Investment Advisers, Advisers Act Release No. 1A-2106, 17 C.F.R. § 275 (Jan. 31, 2003).

consulting services to Shareholder Proponent on the Shareholder Proposal Item 7 "Name of Shareholder Proposal" which was forwarded by Shareholder Proponent."

- Involved Parties: The proxy advisory firm should be required to identify the party with whom the conflict of interest was formed. This would, for example, involve identifying the recipient of consulting services which created a conflict of interest. The proxy advisory firm would also be required to disclose the length of the relationship between the two parties.
- Compensation Received: Proxy advisory firms should be required to disclose any compensation received pursuant to the conflict of interest. For example, if a proxy advisory firm provides consulting services which create a conflict of interest, the proxy advisory firm would be required to disclose the payment received pursuant to those services. Issuers already provide similar disclosures pertaining to independent compensation consultants and auditors.
- Whether Voting Recommendations Differs from Conflicted Party: In order to effectively evaluate whether the conflicts of interest impact voting recommendations, the proxy advisory firm would be required to disclose whether the voting recommendation of the proxy advisory firm differed from that of the conflicted party. For example, suppose an issuer purchased consulting services relating to executive compensation. In the required disclosure, the proxy advisory firm would be required to state whether its voting recommendation on the issuer's say on pay proposal differed from that of management. In another example, if a proxy advisory firm consults with a shareholder proponent on the structure of a shareholder proposal, the proxy advisory firm would be required to disclose whether its voting recommendation on that shareholder proposal differed from the recommendation of the proponent. This framework allows proxy advisory firms to protect propriety recommendations while still allowing the conflicts to be evaluated. Proxy reports already show the proxy advisors recommendation compared to management. In instances where a conflicted party is not an issuer, the proxy advisory firm would be required to add the conflicted party's recommendation alongside its own recommendation within the report.
- Disclosure Format: The disclosure format would change based on where the disclosure was being made. The disclosure would be required to be made in a narrative format but would allow for the use of charts and tables. The use of charts and tables would be designated as being a permissible disclosure format for the website disclosure.

By mandating the above elements, the SEC creates an effective and flexible disclosure regime which effectively allows the disclosure of existing conflicts while also providing an adaptable disclosure template for future conflicts of interest which are not currently envisioned.

Formatted in this manner as demonstrated below, the disclosures allow the institutional investors and advisors to adequately evaluate the proxy advisory firms to determine independence in compliance with the required fiduciary responsibilities. The completeness of the above framework also provides all interested stakeholders the ability to evaluate proxy advisory conflicts in the context of the voting recommendations they issue.

- *Narrative Disclosure for Proxy Report*:

"[Proxy Advisory Firm] provides consulting services to issuers and shareholder proponents on both management and shareholder proposals. [Proxy Advisory Firm] also provides voting recommendations and analyses on these same proposals, creating a potential for a conflict of interest.

In 2018, [Proxy Advisory Firm] provided the [Shareholder Proponent] with consulting services regarding the content and format of shareholder proposal 'Item 8" in the proxy report below. The

value of the consulting services amounted to $45,450. [Proxy Advisory Firm's] voting recommendation with Item 8 aligned with the recommendation of [Shareholder Proponent]. [Shareholder Proponent] received similar consulting services in 2014, 2015, and 2017."

- *Narrative Disclosure for Proxy Report – Proposal Section*:

"[Proxy Advisory Firm] provided [Issuer] with consulting services on Item 4 during 2018 creating the potential for a conflict of interest. The value of the consulting services amounted to $31,100."

- *Website Disclosure – Tabular Format:*

Conflicted Party	**Nature of Conflict**	**Subject Matter**	**Compensation**	**Recommendation Differ from Conflicted Party?**	**Scope of Relationship**
ABC Corporation	Consulting Services	Executive Compensation	$50,000	Yes	2012-2018
ZYX Union	Consulting Services	Buybacks Proposal	$18,800	No	2018

B. The SEC Should Implement a "Five-Day Rule" to Provide Needed Levels of Transparency and Review for Proxy Advisory Firm Analyses

From the perspective of the executive compensation practitioner, the most problematic aspects of the proxy advisory firm status quo involve serious procedural and transparency shortcomings paired with an extreme difficulty in engaging with proxy advisory firms. Specifically, the lack of reasonable access by all issuers to draft proxy reports and the inability of those issuers to adequately review both the draft and final report for errors before publication is highly problematic. The specific concerns regarding the lack of reasonable review of important proxy report data are detailed below.

- *Issuers Lack Reasonable Access to Draft and Final Proxy Reports:* The most serious procedural issue with proxy advisory firms involves the ability of issuers to access both the draft and final proxy report for adequate review. Both major proxy advisory firms have separate policies regarding the review of proxy reports.
  - *ISS Only Provides Draft Proxy Reports to the S&P 500 with Certain Unclear Exceptions:* Currently, ISS provides a draft proxy report to the S&P 500 (as long as the company has registered on ISS's site) two to four weeks before the annual meeting. Outside of that population, issuers do not receive a draft report to review. Even this policy, however, is selectively applied. ISS has developed several reasons for refusing the provide companies with draft reports. For example, draft reports are not provided for any meeting where the agenda includes an M&A proposal, proxy fight or "controversial" items such as a "Vote-No" campaign. For final reports, ISS provides all issuers with a copy upon publication.
  - *Glass Lewis Does Not Provide Draft Proxy Reports, Charges $5,000 for Final Reports*: Glass Lewis does not provide draft reports to issuers and charges $5,000 for issuers to access copies of the final draft report. Glass Lewis does provide issuers with a data-only version of their Proxy Paper report prior to the full paper being provided to investors. The data-only report, which companies may access through the online Meetyl portal, does not contain the analysis or vote recommendations, but does contain the data points used by Glass Lewis to conduct the analysis, and Glass Lewis states that companies should review the data for accuracy. The only way a

company can view the voting analyses and recommendations is by purchasing the report.

- *Issuers Lack A Reasonable Opportunity to Provide Feedback to Proxy Advisory Firms*: Separate from the ability to *access* draft and final proxy reports for reasonable review is the time frame and process for the actual *review* of the content of the draft and final reports. Each proxy advisory firm provides separate frameworks for review of draft reports. Neither firm allows for the review of final reports.
    - *Center Subscribers Report Difficulty Engaging with Proxy Advisory Firms, Especially During Proxy Season*: Center Subscribers report extreme difficulty in engaging with ISS and Glass Lewis within the time constraints of proxy season. Given the workload facing both proxy advisory firms during the truncated period of proxy season, this is unsurprising. This can be problematic, however, when reaching out to the proxy advisory firms to attempt to reconcile or correct errors in data within the draft report.
    - *ISS Provides a Short Review Period for the Draft Proxy Report, No Review Period for Final Report*: According to ISS's website, "[t]he cover letter accompanying the draft report will specify the deadline for the company's comments, *generally* within 1-2 business days after it is distributed. Comments received outside of the deadline are unlikely to be considered before publication of the ISS analysis." [emphasis added]. Almost universally, Center Subscribers reported receiving the draft ISS report Friday afternoon shortly before the opening of the two-day window referenced above. The review of the report is required to be completed early the following week, often by Monday. Given the density of the proxy reports, issuers report extreme difficulties in effectively reviewing and providing the proxy advisory firm with feedback of the draft report. While issuers are provided a copy of the final report, there is no review period prior to its publication. Thus, issuers lack the ability to check to see if errors and corrections submitted to the proxy advisory firm during the draft report review process have been rectified within the final report before its publication.
    - *Glass Lewis Provides No Review Period for Draft or Final Reports*: Issuers have 48 hours to review the data-only version of the proxy paper and provide suggested corrections with the public documentation supporting such corrections. Issuers do not have any ability to review the actual voting recommendations in draft or final form. Issuers are not provided a copy of the final draft report before publication but can purchase a copy for $5,000.

All interested stakeholders, and particularly investment institutions and advisors relying on the data to make fiduciary voting decisions, have a strong vested interest in the veracity and review of the data within both draft and final proxy reports. As demonstrated above, however, the current system does not provide effective avenues for issuers to provide needed feedback and review. Proxy advisory firms also have a propensity for errors and inaccuracies within both draft and final reports.[22]

i. The SEC Should Require Proxy Advisory Firms to Provide All Issuers with a Copy of the Draft and Final Report and Provide a Five Business Day Review Period for Each

[22] A 2014 survey of Center On Executive Compensation Subscribers – chief human resource officers of large companies -- found that of those responding, 55 percent said that a proxy advisory firm had made one or more mistakes in a final published report on the company's compensation programs. Half of those Subscribers reported receiving multiple instances of erroneous or inaccurate information.

Proxy advisory firms evaluate tens of thousands of proxy statements per year. A majority of the proxy statement reviews take place within a short two-month window during proxy season. The magnitude of data analyses and disclosure proxy advisory firms must conduct and review during this time is considerable.

Further, proxy reports are released within a short window before the issuer's annual meeting. The data within the reports is subsequently relied upon by institutional investors in fulfilling their fiduciary duties to vote proxies in the best interest of their shareholders. The extremely abbreviated time window provides little chance for institutional investors – which must vote tens of thousands of proxies for hundreds of companies – to effectively review underlying data of the proxy reports for accuracy and correct characterizations.

Providing issuers with a prescribed period to review both draft and final proxy reports should be a mandatory step within the proxy process. Most simply, an issuer has the capacity to effectively review the data within the proxy reports for accuracy, with the advantage of having the best first-hand knowledge of the data, unlike proxy advisory firms and their institutional investor clients.

Additionally, a mandatory *review* period does not provide an issuer with any ability to "veto" or dictate changes to the data or the recommendations of proxy advisory firms – it is only a *review* of the draft and final proxy reports. Further, given the difficulties with engaging with proxy advisory firms during proxy season and the propensity for high percentages of an issuers shares to be voted on within 24-hours of the release of the proxy report, the review period also allows issuers to establish needed engagement to ensure votes are not cast based on inaccurate data.

All interested stakeholders, including the investors and advisor clients of proxy advisory firms as well as the market in general, will benefit from this added level of review. Additionally, allowing the issuer the ability to review a critical piece of information which will dictate how shareholders vote on the issuer's management and shareholder proposals, provides an important procedural protection currently lacking in the proxy process.

Thus, the Center recommends the SEC require proxy advisory firms to provide the following in order for proxy advisors to qualify for the exemption from the federal proxy solicitation rules under Exchange Act Rule 14a-2(b)(3):

- The draft proxy report be made available to an issuer with a review period of at least five business days; and
- The final proxy report be made available to an issuer with a review period of at least five business days before general publication;

Adding this necessary level of transparency will strengthen the procedural rigor of the proxy process and ensure that votes are cast on sound information with input from all interested and impacted stakeholders.

C. <u>The SEC Should Require Institutional Investors to Disclose the Use of Customized Proxy Voting Policies and Whether Votes Cast Deviated from Proxy Advisory Firm Recommendations</u>

Given the magnitude and scope of proxy advisory firm services, significant concerns exist the regarding the influence proxy advisory firms have over institutional investor voting practices. In addition to providing proxy voting recommendations and analyses, proxy advisory firms also provide clients with the service of casting the proxy ballots on behalf of the client. This service offers an economically efficient way for investors to cast hundreds and thousands of proxy votes.

However, there are significant concerns with the practice which can occur when votes are cast by a proxy advisory firm, based on the recommendations of the proxy advisory firm, without adequate review by the investor-client. Additionally, the practice of "Robo-Voting" is also concerning. Robo-Voting

occurs when investors allow votes to be cast automatically by ISS, based on the proxy advisor's recommendations, without any, or very little review.

As is detailed previously in this letter, when voting proxies, institutional investors and their investment advisors have a fiduciary responsibility to vote in the best interest of their shareholders. The current regulatory framework allows the proxy advisory firm to execute the fiduciary activity of proxy voting without any investor review. The result amounts to a delegation of the fiduciary activity, without disclosure, to the proxy advisory firm. This practice appears widespread with Center Subscribers anecdotally reporting a large percentage of shares are voted within 24 hours of the release of the proxy advisory firm voting recommendations.[23]

The concerns over the lack of an adequate review of voting recommendations are even more significant if considered within the context of the conflicts of interest and procedural shortcomings plaguing the proxy advisory firm industry. Additionally, this current practice eliminates the ability to engage with those investors once the report has been issued because votes typically have already been cast. This is particularly concerning where material inaccuracies are found within the proxy advisory firm proxy report.

ISS offers institutional investor clients the ability to utilize customized voting policies for the purposes of providing the client with voting recommendations. Using a customized voting methodology, the proxy advisory firm can apply the client's preferences as a supplement or replacement to the proxy advisory firm's methodologies in forming proxy voting analyses and recommendations. [24]

The use of customized voting policies provides an investor with the ability to provide a set of customized voting preferences to ISS. This translates to the investor wielding levels of control over the voting recommendations and analyses covered by the policies. There is, however, a lack of transparency concerning what issues are covered by customized voting policies and, to the extent an issue is covered, as to the practical effect of the customized voting policy. Furthermore, whether a fiduciary responsibility can be adequately fulfilled without any investor review is highly questionable.

To address the concerns over Robo-Voting and the lack an adequate review of proxy advisory firm recommendations by investors, the Center recommends the SEC create a new disclosure obligation for the institutional investors which utilize proxy advisory firm voting services. The disclosure would require institutional investors to provide a publicly-filed disclosure which states:

a) Whether the institutional investor and their investment advisor utilize a customized voting policy when engaging proxy advisory firms for proxy voting recommendations and analyses;

b) If a customized voting policy is used, a *brief* explanation of the proxy issues covered by the policy (*e.g*. "Executive Compensation"); and

c) The percentage frequency in which the investor voted in unison with the proxy advisory firm on each issue covered by the customized voting policy.

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[23] Also see Statement of Darla C. Stuckey, Society for Corporate Governance, available at https://www.banking.senate.gov/imo/media/doc/Stuckey%20Testimony%206-28-18.pdf (Last visited November 12, 2018)

[24] "As of January 1, 2018, approximately 85% of ISS' top 100 clients used a custom proxy voting policy. To provide further context, we note that during calendar year 2017, approximately 69% of the ballots processed by ISS on behalf of clients globally were linked to clients' custom policies, representing approximately 87% of the total shares processed by ISS during this period." See ISS Letter to Senate Banking Committee, available at https://www.issgovernance.com/file/duediligence/20180530-iss-letter-to-senate-banking-committee-members.pdf, May 30, 2018 (Last visited October 31, 2018).

The Center believes this disclosure achieves two important objectives:

1. Market participants, through a disclosure, can effectively evaluate the Robo-Voting practices of institutional investors *without* the SEC's intervention beyond implementing the requirement. A wide array of stakeholder groups is impacted by proxy advisory firm recommendations and institutional investor voting practices and thus there is a market-wide need and interest in the information included in the disclosure.
2. The disclosure recognizes the need for institutional investors to maintain a cost-effective way to vote thousands of proxy votes. The SEC could require disclosure after proxy season thus alleviating the burden of having to provide the disclosure during the year's busiest time.

If the SEC chooses not to pursue the Center's disclosure recommendations, the Center urges the SEC to, at the very least, conduct a study on institutional shareholder voting practices, including Robo-Voting, to evaluate whether investors are delegating an important fiduciary duty to proxy advisory firms without effective review of the voting recommendations and oversight of the proxy advisory firms.

D. The SEC Should Require Proxy Advisory Firms to Provide Methodological Reconciliation Utilizing Disclosed Issuer Financial and Compensation Information

Proxy advisory firms employ proprietary methodologies to analyze publicly disclosed issuer information for the purposes of creating voting analyses and recommendations for their clients. However, the unique nature of individual issuer financial structures, corporate strategies, and executive compensation programs effectively renders proxy advisory firms unable to thoroughly evaluate issuers' programs on an individualized basis.

Thus, the methodologies which proxy advisory firms rely upon to address the volume of voting recommendations and analyses employ a broad "cookie cutter" framework that cannot accommodate the unique nature of each individual issuer and their respective corporate governance and executive compensation strategies. As a result, the cookie-cutter approach to the methodologies proxy advisory firms utilize to evaluate issuer executive compensation decisions often yield recommendations based on a different set of assumptions and inputs than those on which the issuer acted.

The Center understands that proxy advisory firms are faced with evaluating detailed financial and executive compensation information for thousands of companies and thus need an efficient manner in which to generate voting analyses and recommendations. However, as currently structured, the proxy reports and recommendations, which are subsequently relied upon to fulfill a fiduciary proxy voting activity, do not include enough information to allow that fiduciary duty to be effectively discharged.

To allow investors to view the entire scope of the analysis of an issuer's compensation program, the Center urges the SEC to require proxy advisory firms to reconcile the proxy advisory firm's analysis by also conducting its analysis utilizing the issuer's financial information disclosed in the 10-K and compensation information (including the issuer's peer group and equity valuations) included in the proxy statement.[25] The disclosure should be required in order for proxy advisors to qualify for the exemption from the federal proxy solicitation rules under Exchange Act Rule 14a-2(b)(3).

Proxy advisory firms already include an issuer's financial and executive compensation information spread out throughout the proxy report. However, the presentation of the proxy advisory firm's analysis and recommendations based on its own methodologies does not provide any insight as to how the analysis and recommendations would differ if it had used the same information and assumptions on which the company operated.

[25] In parallel, issuers are already required to provide reconciliation of Non-GAAP financial figures in order to allow investors to view the entire scope of available information.

For example, ISS utilizes a peer group selection process for the purposes of the executive compensation analysis which often results in a significantly different peer group than was utilized by the issuer in making executive compensation decisions. While ISS does note how the peer groups differed, the subsequent application of its executive compensation methodology utilizes only its own custom peer group for the issuer for the purposes of creating a voting recommendation. This information, without providing the full picture of the analysis by showing the impact on the analysis of the issuer's selected peers, is relied upon by investors carrying out a fiduciary duty.

Providing a side-by-side comparison of the proxy advisory firm's pay, performance and cost analysis using the company's assumptions alongside the analysis using proxy advisory firm's own assumptions provides investors with the complete picture of the analyses to allow for informed fiduciary decision-making, which is currently lacking in the current process.

E. The SEC Should Require Proxy Advisory Firms to Implement Policy Changes on a Rolling Fiscal Year Schedule

Proxy Advisory Firms have an annual process by which they update the policies on which voting recommendations will be based. For ISS, this process begins after proxy season in August each year and finishes in December of the same year. Glass Lewis does not have a formal policy process and issues information about policy updates when changes are made. For calendar year issuers, however, the timing of when new policies are finalized and implemented is very problematic. Calendar year issuers begin the executive compensation process for the upcoming fiscal year in the Summer and the majority, if not all, of the major decisions for the upcoming year are completed by mid-December.

Because of the timing disconnect, many issuers are faced with having already implemented changes that diverge from or fail to account for changes in updated proxy advisory firm policies because the proxy advisory firm policy did not yet exist. The divergence this can create has the potential to significantly impact the proxy advisory firm's recommendations--and thus the issuer--given the influence of proxy advisory firm policies.

Rather than requiring proxy advisory firms to implement restrictions or changes to their policy creation process, the Center believes the SEC should require proxy advisory firms to implement any policy changes only at the beginning of the start of the next fiscal year. Thus, a policy change in ISS which is finalized and made public in December would first apply to proxy votes which take place after the completion of the fiscal year beginning in January. For example, for a calendar-year company, if the proxy advisor's policy change was announced in December 2018, the policy would apply to proxy votes in spring of 2020, based on the information filed for the 2019 fiscal year. The policy should be required in order for a proxy advisor to qualify for the exemption from the federal proxy solicitation rules under Exchange Act Rule 14a-2(b)(3).

This framework allows companies which make compensation decisions to not be judged retroactively by proxy advisory firms. At the same time, this allows proxy advisors to maintain existing policy creation strategies.

Shareholder Resolutions

As detailed above, the current proxy process has not evolved to appropriately accommodate the current state of shareholder proposal practices. The ability to submit proposals to an issuer for a shareholder vote provides an important governance mechanism in the proxy process. This ability is not unlimited, however. Through Exchange Act Rule 14a-8, the federal securities laws provide several parameters for the submission of shareholder proposals which are generally divided into three categories:

1. Ownership Requirements: Shareholders must meet minimum standards of ownership in an issuer in order to be eligible to submit a proposal to an issuer;

2. Subject Matter: Shareholder proposals must fit within a permissible scope of subject matters.
3. Resubmission Requirements: Shareholder proposals which are voted on can only be re-submitted to an issuer on having met minimum shareholder support thresholds.

Currently, through artificially low resubmission thresholds, the proxy process permits frivolous shareholder proposals which receive a mere 11% shareholder support to be submitted annually in perpetuity. The repeated inclusion of these specific shareholder proposals does not positively serve shareholders and imposes unnecessary costs on issuers. Further, given the increase in social and environmental shareholder proposals, the subject matter of many repeat proposals may only arguably be connected to an increase in shareholder or stakeholder value. Thus, a more modern mechanism is needed for screening repeat shareholder proposals.

The SEC Should Update the Shareholder Resubmission Thresholds to 6%/15%/30% and Create a Five Vote Cap for Unsuccessful Shareholder Proposals.

The current Exchange Act rules allow a shareholder to resubmit a proposal even if, in some instances, over 90% of shareholders have voted against it. And if a proposal happens to reach 11% support each year, there is no limit to how many times the proposal can be resubmitted even if support fails to increase from that level. As noted, the repeated inclusion of a proposal which nearly nine of 10 shareholders vote against on an annual basis does not serve to benefit shareholders or other stakeholders while also imposing additional costs on issuers.

The SEC has recognized this problem in the past, and in 1997, the SEC proposed raising the thresholds under the Resubmission Rule from the current 3%/6%/10% to a more appropriate 6%/15%/30%. As the SEC stated in the proposing release: "we believe that a proposal that has not achieved these [proposed] levels of support has been fairly tested and stands no significant chance of obtaining the level of voting support required for approval."[26] Additionally, the Center urges the SEC to cap the number of times a shareholder proposal can be unsuccessfully voted on consecutively at five.

The Center's recommendation to increase in the shareholder resubmission thresholds will not negatively impact shareholders in any manner while accomplishing three important objectives:

1. Preserve the ability of shareholders to submit proposals to management: The changes in no way infringe on the ability of any shareholder – institution or retail – to submit shareholder proposals.
2. Emphasize the importance of shareholder proposals by removing frivolous proposals from the proxy ballot: By eliminating a small population of frivolous shareholder proposals from the proxy, shareholders can properly focus on proposals which are important and relevant. To illustrate, according to Center On Executive Compensation data of S&P 500 Shareholder Proposals, the retroactive application of the 6%/15%/30% shareholder proposals to the 2015, 2016, and 2017 proxy seasons would have resulted in a 9% reduction (33 of 364) in eligible shareholder proposals at meetings in 2018. Of the 33 ineligible proposals under the new standard, 22 were voted on in 2015, 2016, and 2017.
3. Preserve the ability of shareholders and issuers to negotiate on key issues raised in shareholder proposals: Recently, there has been a growing practice whereby shareholder proponents submit proposals to an issuer and then negotiate for changes at the issuer based on the withdrawal of the shareholder proposal. The changes in the shareholder resubmission thresholds does not impact this or any other similar practice. Nor would it eliminate the

[26] Proposed Rule: Amendments to Rules on Shareholder Proposals, available at https://www.sec.gov/rules/proposed/34-39093.htm (last visited 11/7/2018).

ability of a proponent whose proposal fails to meet the standard to engage directly with issuers concerning matters important to the proponent.

Conclusion

The Center appreciates this opportunity to provide feedback on the Commission's ongoing effort to streamline the proxy process. If you have any questions about the Center's comments, please do not hesitate to contact me at [redacted].

Sincerely,

Henry Eickelberg
Chief Operating Officer

cc: Securities and Exchange Commission:

Hon. Jay Clayton, Chair
Hon. Kara M. Stein, Commissioner
Hon. Hester Peirce, Commissioner
Hon. Elad Roisman, Commissioner
Hon. Robert Jackson, Commissioner

Appendix A

Center On Executive Compensation

Email Exchange Between ISS Corporate Services and Motorola Solutions Demonstrates Why Conflicts of Interest Must Be Addressed

Exchange Leaves Perception That ISS Consultant Had Unique Insight Into ISS Research Team Approach

One of the core criticisms of proxy advisory firms is the existence of conflicts of interest in their business or ownership structures. With respect to Institutional Shareholder Services, the Center On Executive Compensation and other observers have criticized the conflict of interest between providing consulting services to some of the same issuers on which ISS provides "independent" proxy voting research and recommendations to institutional clients. Despite assurances that the research and consulting arms are separate, the attached recent email exchange between an ISS Corporate Services client representative and a securities counsel at Motorola Solutions demonstrates how the marketing of ISS's consulting services blurs those distinctions.

- In 2013, Motorola Solutions received a no vote recommendation from ISS on its say on pay resolution. Just over 68 percent of Motorola Solutions' shareholders voted in favor of say on pay.
- On September 17, 2013, Motorola's ISS client representative sent an email to his contact in the securities law department of Motorola Solutions stating:

  > "[D]ue to the 2013 negative vote recommendation for [other company's][1] Advisory Vote on Executive Compensation and/or the fact that the proposal received less than 70% voting support (ballot item #2 in the attached analysis), ISS's Research division will be subjecting your next executive compensation proposal to a greater level of scrutiny.
>
> I did want to offer you a chance to talk with one of our senior corporate advisors in order to better understand what this scrutiny will entail. If you'd like to do this at some point, please let me know."

- On September 25, the Motorola Solutions contact responded and asked to set up a call for October 8.
- On September 26, the Motorola Solutions contact requested that someone from the research side of ISS responsible for analyzing the company join the call.

[1] It appears that the representative had sent several emails to companies that had received negative ISS recommendations or say on pay votes below 70%. The representative intended to use Motorola Solution's stock ticker here but forgot to change the email. As a result, the ticker referred to another company that also received a no recommendation and had a low say on pay vote. The Center has confirmed that that company also received a similar email.

- ISS Corporate Services did not arrange for a representative from the research side to be on the call; however, the ISS representative did make it appear as if Corporate Services had unique insight into how the research side analyzed the company in 2013 and the additional scrutiny it would apply in 2014:

  > "We were going to provide you with a better understanding of the reasons for ISS's negative vote recommendation on your 2013 Advisory Vote on Executive Compensation and what you expect [*sic*] in terms of additional scrutiny from ISS's Research side on this issue next year."

- Although not articulated in the email exchange, during the phone call the ISS representative made reference to very high success rates (over 90%) in say on pay votes for companies that engaged ISS Corporate Services after receiving a low vote.

The exchange leaves the impression that by engaging ISS Corporate Services, Motorola Solutions would receive advice and information unavailable elsewhere and that it would give the company an advantage when the ISS research side goes on to analyze its 2014 proxy. In essence, some companies view retaining ISS Corporate Services as giving them a guaranty or at least a greater chance at receiving a favorable evaluation from the research side. The full email is attached. Despite the provocative language hinting at an inside view of ISS research, it contains no disclaimers or warnings that ISS Corporate Services is separate from ISS research and that there is no exchange of information between the two entities.

The exchange is a good example of why such conflicts of interest should be addressed either by the SEC or by a code of conduct.

From: [redacted] [mailto:[redacted]@isscorporateservices.com]
Sent: Tuesday, September 17, 2013 12:41 PM
To: [redacted]
Subject: Alert for MSI due to ISS Negative Vote Recommendation in 2013

Hi [redacted]:

Just wanted to be sure that you were aware that, due to the 2013 negative vote recommendation for [redacted] Advisory Vote on Executive Compensation and/or the fact that the proposal received less than 70% voting support (ballot item #2 in the attached analysis), ISS's Research division will be subjecting your next executive compensation proposal to a greater level of scrutiny.

I did want to offer you a chance to talk with one of our senior corporate advisors in order to better understand what this scrutiny will entail.

If you'd like to do this at some point, please let me know.

Best Regards,

[redacted]

ISS Corporate Programs

301-[redacted]-[redacted]

From: [redacted] [mailto:[redacted]@motorolasolutions.com]
Sent: Wednesday, September 25, 2013 2:00 PM
To: [redacted]
Subject: RE: Alert for MSI due to ISS Negative Vote Recommendation in 2013

[redacted], thank you for the offer to discuss. We would be interested in speaking with your team regarding this matter. It appears that all necessary MSI participants are available on the afternoon of Tuesday, October 8th after 1 p.m. Central Time. If your corporate advisor has availability that day, please let me know and we can schedule a call.

Thank you.

[redacted]
Corporate, Securities and Transactions
Motorola Solutions, Inc.
motorolasolutions.com
O: [redacted]
M: [redacted]
E: [redacted]@motorolasolutions.com

MOTOROLA SOLUTIONS

From: [redacted] [mailto:[redacted]@motorolasolutions.com]
Sent: Thursday, September 26, 2013 11:14 AM
To: [redacted]
Subject: RE: Alert for MSI due to ISS Negative Vote Recommendation in 2013

[redacted],

Thank you for your response. If possible, we would also like to have someone from the Research side familiar with our company attend the call and also [redacted], if he is available.

Thank you.

[redacted]

[redacted]
Corporate, Securities and Transactions
Motorola Solutions, Inc.
motorolasolutions.com
O: [redacted]
M: [redacted]
E: [redacted]@motorolasolutions.com

From: [redacted] [mailto:[redacted]@motorolasolutions.com]
Sent: Monday, October 07, 2013 5:42 PM
To: [redacted]
Cc: [redacted]
Subject: RE: Alert for MSI due to ISS Negative Vote Recommendation in 2013

Great, thank you. We can use my dial in: 1-877-[redacted]-[redacted]; passcode [redacted]

Also, can you please provide a brief outline of the discussion topics so that we are fully prepared?

Thank you.

[redacted]
Corporate, Securities and Transactions
Motorola Solutions, Inc.
motorolasolutions.com
O: [redacted]
M: [redacted]
E: [redacted]@motorolasolutions.com

From: [redacted] [redacted] [mailto:[redacted]@isscorporateserviceses.com]
Sent: Tuesday, October 08, 2013 8:22 AM
To: [redacted] [redacted]
Subject: RE: Alert for MSI due to ISS Negative Vote Recommendation in 2013

Hi [redacted]:

Glad to help!

We were going to provide you with a better understanding of the reasons for ISS's negative vote recommendation on your 2013 Advisory Vote on Executive Compensation and what you expect in terms of additional scrutiny from ISS's Research side on this issue next year.

Best Regards,

[redacted] [redacted]