AFL-CIO
AMERICA'S UNIONS

American Federation of Labor and Congress of Industrial Organizations
815 16th St. NW
Washington, DC 20006
202-637-5000
aflcio.org

February 3, 2020

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

Re: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice [File No. S7-22-19]

Dear Ms. Countryman:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to provide comments on the U.S. Securities and Exchange Commission's proposed amendments to its exemptions from the proxy rules for proxy voting advice (File No. S7-22-19). The AFL-CIO is a voluntary federation of 55 national and international labor unions that represent 12.5 million working people. Union members participate in the capital markets as individual investors as well as participants in pension and employee benefit plans. Many of these pension and employee benefit plans use proxy advisors to fulfil their fiduciary duties to vote at shareholder meetings. We strongly oppose the Commission's proposed rulemaking that will create a special regulatory regime for proxy advisory firms.

For the reasons below, the Commission's proposed rulemaking violates the investor protection requirements of the Securities Exchange Act of 1934 (the "Exchange Act") and the procedural requirements of the Administrative Procedure Act. Prior to the enactment of the Exchange Act, proxy voting at shareholder meetings was opaque and dominated by corporate management. Section 14(a) of the Exchange Act empowered the Commission to regulate the proxy voting process "as necessary or appropriate in the public interest or for the protection of investors." In direct violation of this investor protection mandate, the Commission's proposed rule on proxy voting advice appears intended to strengthen the hand of corporate management over investors.

Proxy voting by pension and employee benefit plans is subject to fiduciary standards under current law. Single-employer and multiemployer plans are subject to the Employee Retirement Income Security Act of 1974 ("ERISA"). Public plans, while not covered by ERISA, are generally subject to comparable fiduciary obligations under state law. According to interpretive guidance by the U.S. Department of Labor, "[t]he fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock." Moreover, ERISA requires that these plan assets be managed in accordance with the "prudent expert" standard of care.[1] This proxy voting authority can be delegated to a plan's investment advisor or it can be retained by a plan's trustee or named fiduciary. Fiduciary duty requires that "in voting proxies, the responsible fiduciary consider those factors that may affect the value of the plan's investment and not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives."[2]

Proposed Codification of the Commission's Interpretation of "Solicitation"

The Commission's proposed revision of its definition of a "solicitation" is arbitrary and capricious because it purports to include entities as "proxy voting advice businesses" whose business practices do not otherwise constitute a solicitation within the meaning of the Securities Exchange Act of 1934. Section 14(a) of the Exchange Act gives the Commission authority to "prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security." The Commission's longstanding Rule 14a-1(l) defines a solicitation to include any "communication to security holders under circumstances reasonably calculated to result in the procurement, execution, or revocation of a proxy."

The Commission's August 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice takes the position that the provision of proxy voting recommendations to clients is a form of a proxy solicitation. To support this view, the Commission's guidance states:

> "The fact that proxy advisory firms typically provide their recommendations shortly before a shareholder meeting further enhances the likelihood that the recommendations are designed to and will influence the final stages of the investment advisers' decision-making process on voting determinations."

The Commission's 2019 guidance also notes that these recommendations are "typically transmitted to the client shortly before the meeting to aid the client's voting determination; and it may be a factor in the client's voting determination."[3] The Commission's proposed rulemaking goes beyond the Commission's 2019 guidance to expand the Rule 14a-1(l) definition of what constitutes a solicitation. Specifically, the Commission proposes to establish yet another definition of a proxy solicitation to include any:

> "person that markets its expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee."

---

[1] ERISA § 404(a), 29 U.S.C. § 1104(a).
[2] Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, including Proxy Voting Policies or Guidelines, U.S. Department of Labor, No. 2016-01, 29 C.F.R. §2509.2016-01. *See also* Field Assistance Bulletin No. 2018-01, U.S. Department of Labor, April 23, 2018.
[3] Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, U.S. Securities and Exchange Commission, Release No. IA-5325 (Aug. 21, 2019) [84 FR 47420 (Sept. 10, 2019)].

Under this new expanded definition, entities that sell proxy voting advice for a fee will be subject to the Commission's proposed regulations even if these entities do not provide recommendations or research in advance of shareholder meetings. It appears that the Commission intends for the proposed rules to apply to any entity who serves as a proxy voting agent for their clients if the entity markets its expertise as a provider of such proxy voting advice.

Notably, the proposed rulemaking includes the registered investment advisors Segal Marco Advisors and Proxy Vote Plus in its categorization of proxy voting advice businesses. But unlike Institutional Shareholder Services, Glass Lewis, or Egan-Jones, these two firms do not make a recommendation – or issue any advice or report – in the sense intended by the proposed rule or the 2019 guidance. Rather, they serve as proxy voting agents, acting as fiduciaries to cast votes for pension and employee benefit plans who have delegated proxy voting authority to these firms as permitted by ERISA. Both Segal Marco Advisors and Proxy Vote Plus vote proxies on behalf of their clients. Segal Marco Advisors supplements its own proxy voting decision-making with purchased research, whereas Proxy Vote Plus relies on proxy statements and other publicly available information. They provide their clients with documentation of the votes cast, including an explanatory rationale after the vote is cast. They do not create research reports or generally communicate their voting intentions to their clients before the votes are cast.

The proxy voting fiduciary services that pension and employee benefit plans obtain from Segal Marco Advisors and Proxy Vote Plus are directly analogous to the proxy voting of shares held by mutual funds by registered investment management companies. Like pension and employee benefit plans, mutual funds have boards of trustees that contract with service providers for investment advice including proxy voting. Proxy votes for shares held by mutual funds are cast by the registered investment management company that is hired to manage the mutual fund's assets. The proxy voting services of Segal Marco Advisors and Proxy Vote Plus are identical to the proxy voting services of registered investment management companies, although proxy voting agents are more likely to price their proxy voting services separately and registered investment management companies typically do not segregate pricing for proxy voting. This is an arbitrary distinction that should not be the basis of a new regulatory regime.

Indeed, even the Commission's proposing release appears ambivalent on whether it intends to include proxy voting agents within the scope of its proposal or not. In places, the Commission singles out Segal Marco Advisors and Proxy Vote Plus by name, but not other proxy voting fiduciaries. Importantly, the release counts Segal Marco Advisors and Proxy Vote Plus – but not others – in its economic analysis. It is difficult for commenters to respond to either the proposal or the Commission's economic analysis, when it is so unclear whether certain entities would be affected or not. We believe moving forward without clarifying the proposed scope of the rule – and seeking comment – would be inappropriate, and the resulting rule would be arbitrary. Moreover, we question the Commission's authority – under Section 14(a) of the Exchange Act and the compelled speech protections of the First Amendment – to require these firms to write reports for the purpose of enforcing a pre-review by the subject companies. We also believe that allowing companies to pre-review the proxy voting determinations of Segal Marco Advisors and Proxy Vote Plus will create legal conflicts with ERISA's fiduciary requirements.

The Commission's proposed rulemaking does not appear to consider the material differences between proxy voting agents such as Segal Marco Advisors and Proxy Vote Plus, and the proxy voting advisors of Institutional Shareholder Services, Glass Lewis, and Egan-Jones. The Commission's proposed rule contemplates that all proxy voting advice businesses will be required to share their research report recommendations with companies. Segal Marco Advisors and Proxy Vote Plus do not make recommendations, much less provide reports on recommendations. This pre-review requirement will create radical and costly changes to the business practices of proxy voting agents, costs that will be borne by pension and employee benefit plans and were not considered in the Commission's economic analysis. Should the Commission move forward with its rulemaking, we strongly urge the Commission to exempt proxy voting agents such as Segal Marco Advisors and Proxy Vote Plus from its final rule.

Registrants' and Other Soliciting Persons' Review of Proxy Voting Advice and Response

We oppose the Commission's proposed amendments to Rule 14a-2(b) that will give companies an overly intrusive opportunity to pre-review proxy voting advice before it is even issued to the clients who paid for the advice. This requirement is in direct conflict with the investor protection requirements of Exchange Act Section 14(a). Inexplicably, the Commission does not propose to give the proponents of shareholder proposals under Rule 14a-8 the same opportunity to pre-review proxy voting advice. The Commission proposes to give companies up to five business days to review and provide feedback on preliminary proxy voting advice. Companies will then have a second opportunity to review the final proxy voting advice in order to decide whether to provide a written response that will be required to be distributed by proxy advisors. Altogether, the dissemination of proxy voting advice may be delayed for up to seven business days as a result of these onerous pre-review requirements. This delay will create undue burdens on investors who rely on proxy voting advice to vote on thousands of shareholder meetings that are customarily held over a compressed time period during the spring proxy season.

The Commission has not made any showing of factual errors or methodological weaknesses in proxy voting advice need correction by companies before it is distributed to clients. The proposed rulemaking's economic analysis found fewer than 100 additional soliciting materials per year on EDGAR in 2016, 2017, or 2018. These company responses represent less than 1 percent of the thousands of U.S. company annual meetings that are covered by proxy voting advisors. Even if one assumes that these responses are to correct factual errors, this asserted error rate is entirely inconsequential and does not establish a need for the proposed rulemaking. Moreover, the majority of these company responses to proxy advisor recommendations fall into the category of a differences of opinion or policy disputes, not factual errors. Perhaps unsurprisingly, companies view their recommendations on how shareholders should vote to be infallible. But proxy voting advice businesses owe a duty of loyalty to their clients, not to the managers of the companies that their clients invest in. Compelling proxy advisors to obtain pre-review of their proxy recommendations is an Orwellian solution to a nonexistent problem.

Of even greater concern to the proxy process is that allowing the pre-review of proxy voting advice by companies will undermine the independence of proxy voting advice. Page 45 of the proposed rulemaking explains that the amendments are intended to provide companies with the opportunity to review and provide feedback on "disagreements with the proxy voting advice, whether factual, methodological or otherwise." The purpose of the "final notice" requirement is to give the company an opportunity to ascertain whether the proxy advisor has "incorporated their feedback" in their advice (page 114) and, if not, to force the proxy advisor to include a digital hyperlink to the company's rebuttal "in the voting advice delivered to clients" (pages 48-49). The release acknowledges the disruption this will cause to proxy advisors, and its attempt to justify the disruption makes clear that the intent of the process is not to promote accuracy but rather so companies can force their views to be included in the proxy advisors' advice:

> "Providing only the review and feedback period would reduce the potential disruptions for proxy voting advice businesses associated with the proposed engagement procedures. However, limiting registrants and other soliciting persons to the review and feedback period, with no subsequent final notice of voting advice also would make it difficult for them to know whether proxy voting advice businesses had incorporated their feedback prior to disseminating their proxy voting advice to clients" (page 144).

We believe these pre-review requirements will chill the expression of proxy voting advice that does not agree with management's opinions. The Commission's August 2019 guidance asserts that companies that disagree with proxy advisors' "opinions" and "beliefs" may sue them under Section 14a-9. Allowing companies to pre-review the voting advice of proxy advisors will provide corporate management with a government-sanctioned opportunity to pressure proxy voting analysts who recommend votes against management.

The Commission's own enforcement actions involving conflicts of interest between stock analyst research and investment banking illustrate the dangers of providing companies with a pre-review opportunity of proxy voting advice.[4] Neither the Commission nor any SRO has every required stock or financial analysts to clear or even provide drafts of reports to the subject companies. Indeed, FINRA has explained that its research analyst rules "prohibit certain conduct where the conflicts are considered too pronounced to be cured by disclosure."[5] One of these rules is FINRA Rule 2241, which addressed the potential for manipulation of stock analyst recommendations when draft analyst reports are shared with subject companies. FINRA Rule 2241 *prohibits* the prepublication review of research reports by subject companies for purposes other than verification of facts, and even then requires strict controls to shield the analyst and the report from management influence. Prior to adoption of this FINRA rule, stock analyst research was routinely embellished to cast favorable light on the investment banking clients of Wall Street firms. Requiring that proxy voting advice be previewed by companies will create the exact same pressures on proxy voting analysts and *inject* conflicts of interest into proxy advice, contrary to the Commission's stated goal, and causing a market failure where there was none.

The Commission also fails to consider the harmful effect on competition that its proposed rules will have on the proxy voting advice industry. The Commission's proposed rule will require that

---

[4] Press Release, "Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking," U.S. Securities and Exchange Commission et.al., April 28, 2003.
[5] "Research Analyst Rules," FINRA, *available at* https://www.finra.org/rules-guidance/key-topics/research-analyst-rules.

proxy voting advice businesses create elaborate processes to allow companies to pre-review their advice before shareholder meetings. The registrant review processes that Institutional Shareholder Services and Glass Lewis currently have in place are not scalable to smaller proxy voting advice businesses. Moreover, as discussed above, Segal Marco Advisors and Proxy Vote Plus do not create research reports that they could furnish to registrants for the required review. They do not have the staffing resources to receive and consider comments and engagement requests from thousands of registrants whose annual meetings they vote at on behalf of their clients each year, nor has the SEC justified requiring them to do so. The current fees charged by proxy voting advice businesses are very modest. The additional burdens created by the proposed regulations and increase in market concentration if smaller proxy voting providers cannot stay in the business will significantly increase costs for investors. By limiting competition and creating barriers to entry, the Commission's proposed rulemaking is likely to result in an even greater reliance by investors on Institutional Shareholder Services and Glass Lewis.

Finally, we also question requiring that proxy voting advice businesses include a hyperlink to company responses. The chilling effect of such a requirement is subject to strict scrutiny under the First Amendment. The Commission's proposed rulemaking is not narrowly tailored to advance a highly important public interest because the Commission's EDGAR electronic filing system already provides companies with an efficient means to communicate their responses to proxy voting advice. As shown by the proposed rulemaking's own economic analysis, many companies already take advantage of EDGAR to electronically distribute additional proxy materials to shareholders. Any concern that shareholders cast their votes after receiving proxy voting advice is fully addressed by the fact that shareholders may change their vote at any time leading up to the annual meeting by casting a subsequently dated proxy card. The Commission's proposed rulemaking does not provide any data or evidence that the current EDGAR filing process for distributing supplemental proxy materials is inadequate.

Conclusion

For these reasons, we strongly oppose the Commission's proposed amendments to its exemptions from the proxy rules for proxy voting advice. The interests of shareholders in receiving timely and independent proxy voting advice should not be made subservient to the desires of companies who wish to avoid an adverse vote recommendation by proxy voting advisors. We respectfully request that the Commission withdraw the proposed rulemaking. Should the Commission move forward with a rulemaking, we urge the Commission to exempt proxy voting agents such as Segal Marco Advisors and Proxy Vote Plus, and to eliminate the proposed requirement that companies be given the opportunity to pre-review proxy voting advice. Thank you for taking the AFL-CIO's views into consideration. If the AFL-CIO can be of further assistance, please contact me at (202) 637-5152 or brees@aflcio.org.

Sincerely,

Brandon J. Rees
Deputy Director, Corporations and Capital Markets