

Corporate Governance

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

February 3, 2020

Re: File No. S7-22-19

Dear SEC Commissioners and Staff:

This letter supplements my previous comments on the subject rulemaking release.

I agree with and endorse the letters filed by Commission's own Investor Advisory Committee, CII, T. Rowe Price, John Coates and Barbara Roper, Nell Minow and others that this proposal is wrongly conceived.

The real problem with proxy advisors are not those listed in the Release. The real problem is the vast majority of investors, even institutional investors, receive *no* advice from proxy advisors. Before enacting new rules, the SEC should explore why that is.

Perhaps the services are too expensive? If so, could that be cured by stimulating more competition? Alternatively, perhaps some investors do not subscribe because they find the research is not firm specific enough. Whatever the reasons, the SEC should consider making no changes to the existing rules around proxy advisors while encouraging two activities.

Proxy Advisor Contests

The SEC could consider a rule waiver on proxy formatting to allow companies to hold a competition for giving public advice on voting items in the proxy filing for their next shareholder's meeting. View links to proposals and SEC correspondence at *Votermedia Shareowner Proposals Campaign*.¹ The proposals were largely inspired by a paper, *Proxy Voting Brand Competition*.² The following is from that paper's conclusion:

First, individual investors could easily raise their voting participation and quality by copying the voting decisions published by some institutional investors on the internet. All that is needed to trigger this change is for internet stockbrokers and other financial websites to offer such voting options in a convenient form.

Second, we can solve most of the shareowners' free-rider problem by paying professional proxy voting advisors with corporate funds directed by shareowner vote. All shareowners would then receive this advice in addition to the board's voting recommendations. Boards naturally resist such competition for influencing votes, but a

¹ <http://www.votermedia.org/proposals>

² By Mark Latham, *Journal of Investment Management*, Vol, 5, No. 1 (2007), pp. 79-90.

majority of investors who recognize the potential advantages could threaten to replace a board that refuses to implement it. This second reform can be applied one company at a time, and would be beneficial with or without the first one.

One such proposal was submitted to Cisco. The resolved clause read as follows:

THEREFORE BE IT RESOLVED that Cisco Systems, Inc. shareowners request the Board of Directors, consistent with their fiduciary duties and state law, to hold a competition for giving public advice on the voting items in the proxy filing for the Cisco 2014 annual shareowners meeting, with these features:

- The competition would offer multiple cash prizes totaling no more than \$50,000.
- Winners would be determined by shareowner vote on the Cisco 2014 proxy.
- To insulate advisor selection from influence by Cisco's management, any person or organization could enter by paying an entry fee.

A series of questions concerning the proposal were raised, which I answered in a blog post as follows:³

Question 1. I understand that your goal here is to increase retail investor participation – a goal we share. I certainly agree that individual investors are at a significant disadvantage without professional advice on their proxy voting.

Response: That's not the main goal, but it would be an additional benefit. The main goal is to solve the shareowners' "free-rider" problem, which hurts institutional investors too. For most investors it is not worth paying for good voting advice, unless you own more than 5% of the shares. (*The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, Ronald J. Gilson and Jeffrey N. Gordon, January 1, 2013)⁴

Using a proxy advisor competition, retail shareowners and many institutional shareowners would have independent analysis available to them for the first time. Institutions that already subscribe to existing services would benefit from greater competition.

Question 2. I think you're understating the costs. As you know from the VIF discussions, I suspect Broadridge will have a heart-attack about attempting to create the type of ballot your proposal contemplates. Legitimate or illegitimate, you are requiring a custom ballot. But that's a minor complaint.

Response: Even now, without a proxy advisor competition, each ballot for each company is "custom" anyway. Our proposed ballot format was worked out through a series of no-action requests and comports with SEC rules. The ballot would be similar to a director election ballot, with a list of advisor names (typically names of advisor organizations instead of people's names on the director ballot), a link to each advisor's website (an extra item that doesn't appear on a director ballot), and check-box voting for each advisor. Any minor additional administrative costs would be far outweighed by the benefits of solving the free-rider problem.

³ <https://www.corpgov.net/2013/11/cisco-systems-proxy-proposal-5-11-qa/>

⁴ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2206391

Question 3. There is a risk of conflicts of interest. First, as we know, insiders at Cisco will vote for the most management-friendly proxy advisor, and are likely to carry the day on that, as most proposals go for management. Second, the company would be hiring the advisor. That is a clear conflict of interest that is only likely to grow over time.

Response: According to FactSet, insiders at Cisco hold 0.3% of outstanding shares. They are in no position to dominate the vote. Additionally, the proposal contemplates four prizes. It is unlikely “management-friendly” allies will win them all. Contestants are free to analyze not only the proxy but also the analysis of other contestants, including any possible conflicts of interest.

The company is not hiring the proxy advisors. The shareowners, not management or the board, chooses which advisors to pay. Unlike the choice of auditors by the board, there is no conflict of interest. What matters is who chooses the payees, not whose money it is (whether you think of it as “company money” or “shareowners’ money”).

Question 4. I don’t think \$50,000 is nearly enough money for a start-up, so that leaves us with ISS and Glass Lewis (GL), who will need to consider the cost to them (or potential benefit) of publicly disclosing their analysis. This could increase pressure on ISS on conflicts of interest and could damage their reputation. \$50K will not be enough to justify that (I recognize it could also be a selling feature for them, but I think a lot of questions will be asked about the payments and any pro-Cisco recommendations).

Response: We agree that ISS and GL are likely to be leery of our proposal for various reasons, mainly because it challenges their current business model and opens a door to competition. If they think no one else will enter, then they would be happy to ignore it and hope it goes away. But if ISS and GL don’t enter, then others definitely will. It’s easy money.

Even \$20,000 is plenty for a startup. A total of \$50,000 is divided into four prizes, so there would be four chances to win, with a maximum of \$20,000. If ISS and GL stay out, then it’s easy to get paid. A former employee of a proxy advisor could enter on his or her own, as an individual. If that works, it may not be just a one-off. It could be the start of a new business model.

We believe the prize money will encourage other entities, such as hedge funds and individual investors with considerable industry specific knowledge, to enter. It is reasonable to expect that increased funding and increased competition will lead to more and better analysis. Of course, ISS, Glass Lewis, PIRC, Manifest and others are free to enter as well. KOLESNIKOFF Governance, based in Australia, already sells analysis one company at a time. It might be very easy for them to enter.

Question 5. How will contestants demonstrate their value? Show last year’s analysis? Do a mock-up of what they would have advised?

Response: They will provide their analysis of the same proxy that allows shareowners to vote on their analysis. So shareowners will vote on advisors *after* reading their analysis. This can easily be accomplished, since the proxy language is publicly available for weeks before the voting deadline. Proxy contestants will place their analysis on their own websites, which would be linked from the proxy ballot.

Question 6. I don't see how this will improve the quality of advice – ISS or Glass Lewis would simply provide their standard analysis. No incentive here for them to do any additional work (It will, of course, result in guidance for retail investors that currently doesn't exist).

Response: As mentioned in Mark Latham's paper, referenced in the proposal (*Proxy Voting Brand Competition*, "Journal of Investment Management", First Quarter 2007; free download at <http://votermedia.org/publications>), ISS spent an average of about \$2,000 per company on analysis because they have to cover thousands of companies, yet were paid by only relatively few subscribers.

The vast majority of shareowners get no advice from either ISS or Glass Lewis. As mentioned above in our response to number three, we expect industry specialists to get involved. ISS and/or Glass Lewis would be free to submit their standard analysis but if their analysis doesn't improve, it may not be enough to win a prize.

Question 7. How would this work in practice? Do shareholders vote every year on the proxy advisor? The longer they stay in place, the higher the risk of conflicts. If this is an annual vote, it will start to get costly and cumbersome.

Response: As the proposal states, *The decision of whether to hold such a competition in subsequent years could be left open.*

Of course, the board or shareowners may choose to introduce similar proposals in future to extend such competitions.

If such contests become routine, administrative expenses will go down and competition will drive contestants to perform better every year.

Companies often use the same auditor year after year. That is much more open to conflicts of interests than an annual proxy advisor contest. Again, if contestants perceive conflicts of interests by other contestants, they are free to point that out. As explained above in number 2, there is no inherent conflict of interest because proxy advisor payees would be chosen by shareowners, not the company or the board.

Question 8. Who will deliver the proxy advice to shareholders? Who bears that cost? This would go through Broadridge, presumably, and the company will pay? Perhaps the proxy statement could just include a link? Would that comport with SEC rules?

Response: Regarding who will pay, as the proposal says,

It could be expected that each proxy advisor would publish advice on its website regarding the Cisco 2014 proxy, but there need be no formal requirement to do so. The incentive to win shareowner voting support and to maintain the advisor's reputation could be considered sufficient motivation for giving quality advice.

Contestants bear the cost. We expect contestants will publish advice on their own websites but they are free to hire Broadridge to get the word out, place ads in the Wall Street Journal, take ads on TV or otherwise communicate without expense to Cisco.

Regarding SEC rules, as stated in the proposal: The Cisco Board could include this voting item in the proxy:

Which of the following proxy advisors do you think deserve cash awards for the usefulness of information they have provided to Cisco shareowners? (You may vote for as many advisors as you like. See each advisor's website for their information for Cisco shareowners. Prizes, of \$20,000, \$15,000, \$10,000 and \$5,000 will be awarded to advisors based on the number of shares voted to approve the usefulness of their advice.)" Then the name and website address of each advisor entered could be listed in chronological order of entry, followed by check-boxes for approval, disapproval and abstention for each entry. The advisor receiving the most approval votes could get first prize, and so on.

This language and methodology was challenged by the Cisco in a [no-action request](#) and was found to comport with SEC rules.

Question 9. Presumably, only one advisor will be selected, which will dramatically increase the influence of that advisor. I know you're seeking to diversify the options – I'm afraid that in practice, this may have the opposite effect.

Response: Your presumption that "only one advisor will be selected" is incorrect. This misunderstanding may have been caused by ISS labelling this proposal to its clients as "Hire Advisor," whereas the proposal title in Cisco's proxy is "Proxy Advisor Competition." The proposal provides four awards. As stated in the proposal:

The competition could offer a first prize of \$20,000, a second prize of \$15,000, a third prize of \$10,000, and a fourth prize of \$5,000. The entry fee could be \$2,000.

There are likely to be more than four entries, and more entries can be expected in the future if such competitions become more widespread. Some proxy advisors may choose to enter all such competitions. Others may choose to specialize in industry specific contests.

If this competition works well (as we think it will), then shareowners can spread it to many widely held corporations. If it fails, the cost is small (a few corporations for a few years). If it succeeds, the benefits could be huge at most corporations for many years going forward.

For diversified investors who hold Cisco and many other firms, it is worth trying (voting yes) if you think there is any significant chance of success, even if there is just a 10% chance of this or modified versions working out. We think the chance is much greater, well over 50%. Of course, we will only find out if an initial proposal, such as this one at Cisco, wins significant approval by shareowners.

Question 10. Will the company assume any legal responsibility by hiring and disseminating third party advice?

Response: The company is neither hiring nor disseminating third party advice. There is no need for company liability here. The shareowners are choosing which advisors to pay. Who knows what lawyers will make of it at first, but over time the legal system should understand that there is no need for company liability, so there won't be any.

Question 11. I'm sure you've thought through these issues and I don't mean to bombard you with questions, but this is a pretty unique and complex idea. Creative, but I'm not sure how practical.

Response: We are delighted to be able to address your questions, and trust we have cleared up many misconceptions, such as there being only one award. If you have additional questions, [please do not hesitate to ask](#). We have been working on this on and off for years. Mark Latham has done considerable "field" testing at universities, municipalities, and cooperative businesses (see VoterMedia.org). We realize the proposal is new to you and welcome your willingness to allow us to explain further the language of the proposal, which as you know is limited to 500 words.

Perhaps one or more of the trade associations that have lobbied in favor of the Release would be willing to provide funds for a few such experiments. They are concerned about a near duopoly. Why not generate more competition and if the information provided is any better?

Real-time Proxy Vote Reporting

The current annual N-PX proxy reporting requirements, promulgated before widespread use of the internet, obfuscate the ability of investors to compare voting records. Compare the sortable voluntary disclosure of Trillium Asset Management⁵ (which often includes voting rationale, with the mandated disclosure of the Vanguard Index Trust Total Stock Market Index Fund, which requires a laborious effort to decipher.⁶

A better way for the SEC to improve proxy analysis and advice would be to increase public scrutiny of how funds vote. Driving competition around votes would drive discussion and the demand for more refined analysis. Some shareholders and fund investors may seek better alignment between fund labels and fund voting. Others may want more focus on short-term shareholder returns, regardless of environmental, social or governance impact. See my rulemaking proposal File 4-748, Report of proxy voting record.⁷

The SEC should focus on increasing public and investor information, not placing what amounts to a tax on proxy advisory services.

Sincerely,



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Corporate Governance (CorpGov.net)

⁵ <https://trilliuminvest.com/approach-to-%20sri/proxy-voting/>),

⁶ <https://www.sec.gov/Archives/edgar/data/36405/000093247118006890/indexfunds0085.htm>

⁷ <https://www.sec.gov/rules/petitions/2019/petn4-748.pdf>