Committee For Justice
Holding Judges and Politicians Accountable to the Constitution

The Committee for Justice
1629 K St. NW Suite 300
Washington, D.C. 20006

(202) 270-7748
committeeforjustice.org
@CmteForJustice

Submitted: February 3, 2020
File No. S7-22-19
Docket ID: SEC-2019-1821-0001

Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

RE: Proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice

ASHLEY BAKER
DIRECTOR OF PUBLIC POLICY
THE COMMITTEE FOR JUSTICE

INTRODUCTION

We at the Committee for Justice ("CFJ") write to the Securities and Exchange Commission ("SEC") regarding its request for public comment[1] on proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice.

Founded in 2002, CFJ is a nonprofit legal and policy organization that promotes and educates the public and policymakers about the rule of law and the benefits of constitutionally limited government. CFJ has recently focused on issues at the intersection of constitutional law and regulatory reform. Consistent with that mission, our latest efforts have encompassed areas such as intellectual property law, antitrust law, privacy law and policy, and administrative law.[2]

---

[1]U.S. Securities and Exchange Commission, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-87457 (Nov. 5, 2019), https://www.sec.gov/rules/proposed/2019/34-87457.pdf.

[2] See, *e.g.* Ashley Baker, Comments Submitted to the FTC Regarding Hearings on Competition and Consumer Protection in the 21st Century, Docket No. FTC-2018-0098. (Dec. 2018), https://www.ftc.gov/system/files/documents/public_comments/2018/12/ftc-2018-0098-d-0033-163368.pdf; Ashley Baker, Comments Submitted to the DOJ Antitrust Division Regarding Competition in Television and Digital Advertising. June 2019, http://bit.ly/2PwehnJ; Curt Levey, The Curious Case of the Trade Secrets that Weren't, IPWatchdog (Sept. 17, 2019), https://www.ipwatchdog.com/2019/09/17/the-curious-case-of-the-trade-secrets-that-werent/id=113344/.

The Committee for Justice
1629 K St. NW Suite 300
Washington, D.C. 20006

(202) 270-7748
committeeforjustice.org
@CmteForJustice

We believe that Securities and Exchange Commission's proposed rule change regarding proxy advisory firms is a positive step towards implementing much-needed reforms. The rules governing the proxy system need to be clarified and modernized for the benefit of investors, public companies, and the U.S. financial services industry as a whole. Therefore, the SEC should implement the proposed rule.

THE INTERESTS AND PRIORITIES OF PROXY FIRMS – AND ADVISORS' BLIND DEFERENCE TO THEM – ARE OUT OF KEEPING WITH THE LEGAL STANDARDS GOVERNING THE REST OF THE FINANCIAL SERVICES INDUSTRY

There are concerns as to whether investment advisors are really fulfilling their fiduciary duties when they rely on recommendations from proxy advisory firms. As explained in a report by the Manhattan Institute:[3]

> "Proxy advisory firms are not held to a fiduciary standard that would require them to demonstrate that their recommendations are in the best interest of shareholders and the corporation— or, at least, no such standard that has been clearly articulated in rules or regulations or litigated in a court of law. This absence of fiduciary duties is salient, given the evidence that at least some institutional investors use proxy advisory firms as a lowest-cost option to meet their own fiduciary voting obligations, without regard to voting accuracy."

The SEC should make clear that proxy advisory firms are subject to a fiduciary duty to their clients and can be held accountable for breaching this duty. When interests of the proxy advisory firm are put ahead of shareholder returns, there are real consequences. For example, those using investments to fund retirement may not meet their planning goals.

Voting in lockstep with the recommendations of proxy advisory firms is known as "robo-voting." This practice may be a violation of fiduciary duties as well as ERISA. Unfortunately, many institutional investors have been disincentivized to carry out their own independent evaluations of proxy votes and governance practices, outsourcing their

[3] James R. Copeland, David F. Larcker, & Brian Tayan, Proxy Advisory Firms: Empirical Evidence and the Case for Reform, The Manhattan Institute, (May 2018), https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf.

shareholder voting policies to a proxy advisory firm that relies on a "one size fits all" approach to assessing corporate governance.

On the other hand, many advisors need to concentrate on making investment decisions and other aspects of their jobs and therefore outsource the duty to vote their proxies. Smaller entities are likely to engage in the practice of robo-voting because they don't necessarily have the resources to process the hundreds of proposals each year. They rely on proxy advisory data, analysis, and recommendations. However, these firms are not accountable to the same rules and regulations and are not necessarily operating in the best interests of investors.

Notably, firms have political and ideological agendas that present conflicts. Glass Lewis and ISS support "environmental, social and governance" guidance despite studies that this type of corporate strategy often fails to produce the best returns for investors. Sometimes this guidance involves excluding ownership in entities and industries that are deemed at odds with these environmental and social goals and beliefs, even when these entities outperform the market. For the vast majority of investors, the primary goal is to maximize return on investment (ROI). For ISS and Glass Lewis, ROI takes a backseat to many other subjective beliefs and interests.

TO DETERMINE HOW CONSULTING AGREEMENTS AFFECT THE QUALITY OF RECOMMENDATIONS, FIRMS SHOULD BE REQUIRED TO DISCLOSE ISSUERS WITH WHICH THEY RETAIN A COMMERCIAL RELATIONSHIP

Proxy advisory firms cannot possibly serve the interests of both corporations and investors, and yet some of these firms continue to provide corporate-governance consulting services to some of the same companies for which it offers voting recommendations.

As Glass Lewis admitted in a letter to the Senate Banking Committee, "unlike ISS, Glass Lewis does not provide consulting services to issuers. We believe the provision of consulting services creates a problematic conflict of interest that goes against the very governance principles that proxy advisors like ourselves advocate."[4] Indeed, conflicts that would be material should be disclosed.

The ownership of proxy advisory firms presents another conflict. Glass Lewis is jointly owned by the Ontario Teacher's Pension Board and a hedge fund, Alberta Investment Management Corporation. ISS is owned by private equity firm Genstar Capital. These investment firms have a stake in the firms that the that the proxy statement would affect.

Proxy advisory firms should be required to disclose issuers with which they retain a commercial relationship. While it is currently unclear if and how consulting agreements affect the quality of proxy advisor recommendations, the data obtained through disclosure would enable research that could shed light on the conflicts created by these dual service offerings.

THE PROBLEM IS NOT MERELY THAT PROXY FIRMS ARE "UNREGULATED," BUT THAT THESE FIRMS ARE INSULATED FROM BOTH REGULATION AND FROM MARKET FORCES

The firms exhibit signs of market failure, but the market has not been able to eliminate them. In a properly functioning market, firms with a poor service record are driven from the market. Proxy advisory firms are insulated from these forces. The Commission's proposal would let the market decide. Currently, however, due to the lack of transparency that is so pervasive in this process investors lack the information needed to properly inform their concerns.

While there is anecdotal evidence of the concerns of investors in the many public comments submitted to the Commission, a recent study provides reliable data on the matter.[5] In November, Spectrum conducted a 9-day survey of more than 5,000 investors

[4] Glass Lewis, Letter to the Senate Banking Committee, (May, 9 2018), http://www.glasslewis.com/wp-content/uploads/2018/06/Glass-Lewis-Response-to-May-9- 2018-Chairman-Heller-Letter_0601_FINAL.pdf

[5] Tom Zanki, Law360, (January 9, 2020), https://www.law360.com/compliance/articles/1232829/survey-says-retail-investors-want-more-proxy-firm-scrutiny.

The Committee for Justice
1629 K St. NW Suite 300
Washington, D.C. 20006

(202) 270-7748
committeeforjustice.org
@CmteForJustice

who hold at least $10,000 in assets through various accounts containing stocks, bonds, mutual funds and exchange-traded funds (ETFs).[6] The findings were are as follows:

- ***Increased Scrutiny:*** 81% of retail investors support more scrutiny of proxy firms.
- ***Review and Response:*** 79% of retail investors support the SEC's proposal to require proxy firms to give companies more opportunity to review and respond to proxy voting advice before matters are voted on.
- ***Conflicts of Interest:*** 78% of retail investors support requiring proxy firms to disclose conflicts of interest
- ***Robo-voting:*** 81% of survey respondents said they were concerned about robo-voting (notably, 35% said they're "very concerned")

CONCLUSION

The Commission's proposal is consistent with our disclosure-based regulatory system. The prosperity of the financial services industry, and thus the assets of millions of Americans and the U.S. economy as a whole, rests on having clear rules within a disclosure-based regulatory framework. The SEC has taken a balanced approach that serves the shareholders.

[6] Press Release, Spectrem Group Study Reveals Wide Retail Investor Support for Proposed SEC Amendments, PR Newswire, (Jan. 10, 2020), https://www.prnewswire.com/news-releases/spectrem-group-study-reveals-wide-retail-investor-support-for-proposed-sec-amendments--january-10-2020-300984956.html.