

Kevin A. Beaugez
[REDACTED]
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3 June 2020

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

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

To the Commissioners and staff of the SEC:

Kudos to the SEC on yet another thoughtful, thorough, and well-executed proposed rulemaking. I write today in my private capacity as a citizen generally interested in supporting the SEC's mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." In this letter, I make three recommendations:

- The SEC should modify its proposed rule to allow for a contemporaneous review period for proxy voting advice
- The SEC should further clarify the standard of conduct for proxy advisory services which would give rise to liability under Rule 14a-9
- The SEC should interpret the Investment Advisers Act of 1940 to require proxy advisors to register as investment advisers

I. THE SEC SHOULD ALLOW A CONTEMPORANEOUS REVIEW PERIOD FOR PROXY VOTING ADVICE

The SEC proposed that Rule 14a-2(b)(9)(ii) would require, as a condition to reliance on certain exemptions, the proxy advisory business must provide issuers and other soliciting persons time to review and provide feedback on the advice before it is disseminated to the proxy advisor's clients. This review time varies based on how far in advance of the shareholder meeting the definitive proxy is filed. Currently, however, it appears that the SEC is considering abandoning this part of the proposal. The SEC should **NOT** wholly abandon the review period, but rather lessen the regulatory burden by allowing for contemporaneous review. This contemporaneous review period should allow for proxy advisory businesses to send their recommendations to clients and to issuers at the same time, rather than to issuers in advance. If the issuer decides that there are material errors or omissions, it should promptly notify the proxy advisory business of the errors. Then, the proxy advisory business should be required to

disseminate to clients, via hyperlink or other means, the materials provided by the issuer necessary to correct the error or omission.

It is no secret that the SEC's proposed rule came under fire from the major proxy advisory businesses and institutional investors. A frequent argument by critics of the SEC's proposed rule is that limiting the autonomy of proxy advisory firms will lead to a shift in power from shareholders to management.¹ For example, Glass Lewis claimed that allowing a board to review would give the corporation "an opportunity to lobby Glass Lewis for a change in policy or a specific recommendation against management."² Glass Lewis contends that *not* engaging with the corporation until after the proxy solicitation period has ended adds to the objectivity of the voting recommendations.³ Other academics agree with Glass Lewis and argue that corporations may feel pressured to adopt the views of proxy advisors simply to gain shareholder approval.⁴

The arguments made by Glass Lewis and others are at least facially plausible. If the proxy advisory business has no contact with the corporation's board, then there is no way for the board to exert undue influence on the proxy advisor. Requiring proxy advisors to turn over their analysis and methodologies to corporate leadership for review might have a chilling effect on the proxy advisory industry. Proxy advisors might not want to open themselves up to litigation, which would result in shareholders receiving less access to voting advice and recommendations.

Nevertheless, other considerations show that a contemporaneous review period is necessary to protect investors from errors in proxy voting recommendations. Proxy advisors improperly frame this argument as a battle between shareholders and management. This approach is misguided because it fails to address a core concern of securities regulation—disclosure. The debate should not be about "management vs. investors," but rather as "disclosure vs. non-disclosure." To make the best possible vote, shareholders need to be fully informed of all possible reasons to vote for or against a director or other matter up for vote. If the board does not have a meaningful opportunity to correct any errors in a voting requirement, shareholders are harmed by a lack of high-quality information. Thus, allowing for review of voting advice benefits both management *and* investors. Investors benefit by receiving input from both proxy

¹ See e.g. Comment, Institutional Shareholder Services at 84 (Jan. 30, 2020) <https://www.sec.gov/comments/s7-22-19/s72219-6732023-207470.pdf> ("The real beneficiaries of the proposed review, feedback and response provisions would be many self-interested corporate insiders, who, after decades of trying, will finally have a 'role to play' in vetting the sources of independent information shareholders use in making their proxy voting decisions.")

² Letter, Katherine Rabin, Glass, Lewis & Co., LLC at 8 (Nov. 14, 2018) <https://www.glasslewis.com/wp-content/uploads/2018/11/GL-SEC-Roundtable-Statement-111418.pdf>.

³ *Id.*

⁴ George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1295 (2014).

advisors and corporate management, while management benefits from being able to correct any errors or weaknesses in the proxy advisor's voting advice.

In the fight for better, fairer, more transparent securities markets, more information is generally better than less information. As the Supreme Court explained in *Virginia Bankshares, Inc. v. Sandberg*, "the share owner faced with a proxy request will think it important to know the directors' beliefs about the course they recommend, and their specific reasons for urging the stockholders to embrace it."⁵ Allowing for a contemporaneous review period allows for a client of a proxy advisory business to arm herself with both the voting recommendation offered by the proxy advisor and the management's response to any inaccuracies.

In sum, if a proxy advisor is mistaken about any facet of its voting advice, management should be allowed to respond meaningfully. A contemporaneous review period strikes the proper middle ground between burdensome regulation and unaccountable voting advice.

II. THE SEC NEEDS TO CLARIFY THE STANDARD OF CONDUCT FOR THE PRODUCTION OF VOTING ADVICE UNDER RULE 14a-9

A second proposed rule change is to expand upon the list of misleading activities which could give rise to liability under Rule 14a-9. The proposed rule would classify a proxy advisor's failure to disclose the methodology, sources of information, and conflicts of interest as examples of misleading activity. I think this change is appropriate, but I do not believe that the SEC has sufficiently explained what kind of conduct would give rise to liability. Before proxy advisors become inundated with lawsuits, the SEC should further elucidate the standard of conduct through either a staff legal bulletin or further rulemaking.

Rule 14a-9, promulgated under 14(a) of the Securities Exchange Act of 1934, provides that no proxy solicitation shall be made which is "false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading."⁶ Courts have explained that the "purpose of the provision is to insure that shareholders are provided with complete, truthful and accurate information before deciding whether to grant, withhold or revoke a proxy."⁷ Looking to legislative history, the primary objective of proxy regulation is to provide shareholders with adequate information to

⁵ 501 U.S. 1083, 1091 (1991).

⁶ 17 C.F.R. § 240.14a-9. Materiality is generally described as a requirement that the plaintiff shows that "the defect [has] a significant propensity to affect the voting process." *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970). "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 439 (1976).

⁷ *Woodward & Lothrop, Inc. v. Schnabel*, 593 F. Supp. 1385, 1392 (D.D.C. 1984).

assist them in the voting process.⁸ This information could include matters such as the financial condition of the corporation and questions of policy to be decided at shareholder meetings.⁹ The general theory is that the shareholder right to elect directors is meaningless unless the shareholders can objectively evaluate board performance.¹⁰

One critical weapon at the SEC's disposal in the fight against impropriety in the proxy voting process is that scienter need not be proven to establish a violation of Rule 14a-9.¹¹ Instead, a plaintiff (including the SEC or a private party) must only show that the defendant acted with negligence.¹² Similarly, only negligence is required to sustain a violation of Rule 206(4)-6, which sets out the fiduciary rules for investment advisers engaging in proxy voting.¹³

Based on the proposed rule changes and existing case law, it appears, but is not wholly clear, as though the SEC can now pursue an enforcement action against a proxy advisor for negligently providing voting recommendations. Specifically, the SEC mentioned that failing to "disclose information such as the proxy voting advice business's methodology, sources of information and conflicts of interest" would be violative of Rule 14a-9.¹⁴

I believe that the SEC's proposed rule is not clear enough with regards to the standard of conduct which would give rise to liability. Before potentially opening proxy advisory business to a wave of litigation, the SEC should clarify which specific conduct is proscribed under Rule 14a-9. In so doing, the SEC should revise its current proposal to address the following concerns:

- Would the SEC bring an enforcement action against a proxy advisory business for negligently prepared voting advice? If so, how would the SEC determine that the voting advice was deficient in some material way?
- How will the SEC or a private plaintiff evaluate the proxy advisors' voting methodologies? Must the proxy advisor develop customized voting

⁸ Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1178 (1993) *citing* Report on Stock Exchange Practices, S. Rep. No. 1455, 73d Cong., 2d Sess. (1934).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973).

¹² "The elements of a claim under § 14(a) of the 1934 Act and rule 14a-9 are threefold. The plaintiff must establish that: (i) the proxy statement contained a material misrepresentation or omission; (ii) that the defendants were at least negligent; and (iii) that the proxy statement was an essential link in the completion of the transaction at issue." *Lane v. Page*, 581 F. Supp. 2d 1094, 1110-11 (D.N.M. 2008).

¹³ *S.E.C. v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992).

¹⁴ *Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice*, Exchange Act Release No. 87457 at 70 (Nov 5, 2019).

methodologies based on a client's interests? If so, must the voting advice comport with a fiduciary standard, a best interest standard, or some other standard?

- How thoroughly should a proxy advisor vet the sources of information upon which a voting recommendation rests? Are there circumstances in which a proxy advisor can reasonably rely on sources of information **not** prepared by the proxy advisor?
- Would the standard of conduct be based on degree of diligence, care, and skill which ordinarily prudent proxy advisors would exercise under similar circumstances? If so, how would that standard of conduct be developed?
- Is there any way for a proxy advisor to preserve the confidentiality of methodologies or sources of information?

In answering these questions, it might be helpful for the SEC to prepare guidance similar to that of Staff Legal Bulletin 20,¹⁵ which provided necessary clarification of the proxy voting system as it exists today. If there are any changes to the proxy voting regulator climate, a legal bulletin styled in the question-and-answer format is the best way to set out the necessary information for regulated parties and their counsel.

III. PROXY ADVISORY BUSINESSES SHOULD REGISTER AS INVESTMENT ADVISERS

My final remark is a recommendation which is not directly covered in the proposed rulemaking, but merits further consideration. In its proposed rule, the SEC asks, “[i]s there a different, more appropriate way of distinguishing proxy voting advice from other forms of investment advice?”¹⁶ To answer this question, I urge the SEC to interpret the Investment Advisers Act of 1940 to determine that furnishing proxy voting advice is a type of investment advice. In so doing, proxy advisors should be required to register with the SEC as investment advisers.¹⁷

Unsurprisingly, Glass Lewis opposes this approach and claims that there are fundamental differences between investment advisors and proxy advisors. In a comment to pending federal legislation on this matter, Glass Lewis claims that:

¹⁵ *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*, Staff Legal Bulletin 20 (June 30, 2014) <https://www.sec.gov/interps/legal/cfslb20.htm>.

¹⁶ *Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice*, Exchange Act Release No. 87457 at 22 (Nov 5, 2019).

¹⁷ An investment adviser cannot register with the SEC unless that adviser qualifies for federal registration under 17 C.F.R. § 275.203A. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996).

“[t]he Investment Advisers Act was not originally designed to oversee and monitor the nuanced activities of a proxy advisory firm, but was tailored with the investment adviser in mind. Proxy advisors neither advise their clients whether to purchase, sell or hold securities nor do they manage client investments. The Investment Advisers Act is principally about disclosure, with only a few substantive requirements, most of which would not apply to proxy voting advice”¹⁸

Glass Lewis is at least partially correct: fitting the square peg of proxy advisory into the round hole of an investment adviser presents some difficulty. Under the traditional view of the role played by an investment adviser, an investment adviser simply offers investment management advice through recommendations to buy or sell securities. But before adopting Glass Lewis’ position, we need to take a hard look at the statutory text. As currently codified, the Investment Advisers Act defines an investment adviser as:

“any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or *who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities*”¹⁹

At first glance, a proxy advisor is not an investment adviser because proxy advisors do not advise about the value of securities or the advisability of investing in securities. The latter half of the definition, however, seems to encompass the normal business activities of proxy advisors. When a proxy advisor analyzes a corporation and issues a recommendation as to how to vote a proxy, it is issuing a report concerning securities and therefore acts as an investment adviser. Voting on shareholder proposals is the lifeblood of the corporate form²⁰ and therefore it follows that a report which seeks to sway shareholders into voting for or against a director qualifies as a report concerning securities. Exercising voting authority significantly affects the future value of issuers, and therefore a voting recommendation is a report concerning securities.

From my research, it appears as though ISS calls for the regulation of proxy advisors as investment advisers.²¹ ISS writes that “[p]roxy advisors also issue research reports about

¹⁸ Nichol Garzon, *Legislative Update: Senate Bill Redefines Proxy Advisors as Investment Advisers*, Glass Lewis (Nov 15, 2018) <https://www.glasslewis.com/legislative-update-senate-bill-redefines-proxy-advisors-as-investment-advisers/>.

¹⁹ 15 U.S.C. § 80b-2(a)(11) (emphasis added).

²⁰ See eg *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (explaining that “[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”)

²¹ Comment, Institutional Shareholder Services at 26 (Jan. 30, 2020) <https://www.sec.gov/comments/s7-22-19/s72219-6732023-207470.pdf>.

companies, their boards and management and their securities, so that their investor clients can understand and assess the vote recommendations. In so doing, proxy advisers issue or promulgate analyses or reports concerning securities.”²²

The upshot of this statutory analysis is that all firms engaged in proxy advisory must register with the SEC as investment advisers. Not only is this approach sensible from a statutory interpretation approach, it is also sensible from an operational perspective. One of the key goals of the SEC is to monitor risk in the securities market.²³ To support this goal, the SEC entrusts OCIE with the power to oversee key market participants.²⁴ Currently, OCIE conducts examinations of investment advisers, but OCIE does not have direct authority to examine the activities of proxy advisors who are unregistered with the SEC. OCIE conducted examinations of proxy advisors in 2015,²⁵ but I have not found public records stating that OCIE has conducted any examinations of proxy advisors since 2015.

One of the greatest tools at the SEC’s disposal is the ability to conduct on-site exams of market participants. But the fact that only three of the five major proxy advisory firms are registered as investment advisers²⁶ severely hampers OCIE’s examination ability. A single round of examinations five years ago is not enough to protect investors from potential risks. If proxy advisors register as investment advisers, OCIE can conduct regular examinations of these entities to ensure compliance with the federal securities laws.

²² *Id.* One might think that ISS and Glass Lewis would agree on the registration of proxy advisory businesses, as both are proxy advisors, but their disagreement is expected because of differing regulatory standing. ISS is a registered investment adviser, but Glass Lewis not a registered adviser. As such, ISS is incentivized to call for greater regulation on its economic rival, despite their alignment on other issues.

²³ *What We Do*, U.S. Securities and Exchange Commission <https://www.sec.gov/Article/whatwedo.html>.

²⁴ OCIE oversees investment advisers, investment companies, broker dealers, exchanges, self-regulatory organizations (“SROs”), clearing agencies, and transfer agents. *About the Office of Compliance Inspections and Examinations*, U.S. Securities and Exchange Commission <https://www.sec.gov/ocie/Article/ocie-about.html>.

²⁵ *Examination Priorities for 2015*, U.S. Securities and Exchange Commission at 4 (Jan. 13, 2015). <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf>. The GAO reviewed the examinations and found “[n]one of the examinations we reviewed resulted in serious violations leading to an enforcement action.” *Corporate Shareholder Meetings: Proxy Advisory Firms’ Role in Voting and Corporate Governance Practices*, Government Accountability Office 17-47 at 36 (Nov. 2016) <https://www.gao.gov/assets/690/681050.pdf>.

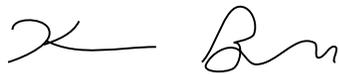
²⁶ ISS, Segal Marco Advisors, and ProxyVote Plus are investment advisers, while Egan-Jones is a registered NRSRO. Glass Lewis is not registered with the SEC in any capacity.

In sum, proxy advisors should be considered investment advisers based on both a logical reading of legislative text and also the regulatory benefits stemming from this distinction. As you are well aware, Congress enacted the Investment Advisers Act to “achieve a high standard of business ethics in the securities industry.”²⁷ The SEC can better ensure this high standard of business ethics through a pragmatic use of registration and examination.

IV. CONCLUSION

The SEC has a great opportunity to use its rulemaking authority to enhance the proxy voting process for investors. While the rulemaking as initially drafted is a good first step, the SEC should modify this rule to allow for contemporaneous review and to clarify the standard of conduct for proxy voting recommendations under Rule 14a-9. Furthermore, the SEC should consider interpreting the Investment Advisers act to require proxy advisors to register with as investment advisers. Thank you for your time and consideration on this matter.

Warm Regards,

A handwritten signature in black ink, appearing to read "K Beaugez". The signature is fluid and cursive, with a large initial "K" and a stylized "Beaugez".

Kevin A. Beaugez
Concerned Citizen

²⁷ SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).