MORNINGSTAR®

22 West Washington Street
Chicago
Illinois 60602

Telephone: +1 312 696-6000
Facsimile: +1 312 696-6001

February 3, 2020

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

Re: Release No. 34-87458; File No. S7-23-19, RIN 3235-AM49, Proposed Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8.

Ladies and Gentlemen:

Thank you for the opportunity to share our views on the Proposed Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (Proposed Rule).

Morningstar brings two different perspectives to the questions in the request for comment. First, as the owner of a comprehensive U.S. fund proxy voting database, we have been tracking proxy voting in all mutual funds since 2004. We track shareholder resolutions by category and how individual fund managers have voted on these resolutions. Through this fund-level analysis, we assess how well asset managers are performing their fiduciary duty with respect to sustainability. Second, through our partnership with Sustainalytics, we utilize company-level ESG ratings to aggregate the company-level data up to the fund level. In this way, we evaluate funds and how they perform along a variety of ESG dimensions.

In this letter, we address the consequences of the proposed rule on shareholder engagement and shareholder voice in voting, particularly on issues that may show large swings in support due to current events; and of the Momentum Requirement for resubmissions, which, taken together with the "substantially the same" disqualifier, could have a significant impact on preventing meritorious and important shareholder resolutions, which have been the cornerstone of U.S. investing and corporate governance for decades.[1]

[1]Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (Securities and Exchange Commission) P. 66417. https://www.govinfo.gov/content/pkg/FR-2019-12-04/pdf/2019-24476.pdf (Proposed Rule).

I. Shareholder Resolutions Do Not Burden Corporations

Morningstar believes that this rulemaking is not necessary for the protection of investors. Instead, the proposal would make it more difficult for shareholders to exercise their voices in corporate governance. The proposal raises the current resubmission thresholds of 3% of votes cast if previously voted on once in the past five years, 6% of votes cast if previously voted on twice in the past five years, and 10% of votes cast if previously voted on three times or more during the past five years to new thresholds of 5%, 15%, and 25%, respectively (in all of these cases, the most recent vote must be in the past three years).[2] The Sustainability Investments Institute estimates that these changes would have disqualified more than 600 ESG proposals since 2010.[3] Furthermore, currently, a shareholder needs to own $2,000 of company stock continuously for one year to submit a proposal.[4] Under the proposed rule, a shareholder needs to own $2,000 of securities entitled to vote on the proposal for at least three years; $15,000 for at least two years; and $25,000 for at least one year.[5] We see no reason for these increased holding requirements; they are clearly intended to deter a greater number of shareholders from having an impact on corporate governance. The Securities and Exchange Commission (Commission) assumes that shareholder resolutions brought "year after year" that do not attain majority support are burdensome and unjustified, and we believe the Commission fails to account for the value they bring to both corporate and societal dialogue on significant issues pertinent to market risk.[6]

We believe the proposed rule will stifle investors' voices. Investors are continually learning about how various risks, including those that become the subject of shareholder resolutions, affect their investment portfolios. Shareholders often need time to learn and educate their peers about risks. The 2019 proxy season demonstrated that shareholders now are more concerned about climate risk,[7] along with human rights risks[8] and corporate political activity[9] that present reputational risk. New research and data have an impact on shareholder learning. For instance, understanding around climate change and its materiality to investment performance has evolved over time.

[2]Proposed Rule, P. 66458, 66460.
[3]Whieldon, E. 2020. "SEC Proposed Rule Would Have Blocked 614 ESG Resolutions since 2010, Data Shows." (S&P Global) P. 1. https://www.spglobal.com/marketintelligence/en/news-insights/trending/dgOXuoNlWkBNX2hmo3bHlg2 (ESG Resolutions).
[4]Proposed Rule, P. 66463.
[5]Proposed Rule, P. 66463.
[6]Proposed Rule, P. 66470.
[7]Cook, J. 2019. "Proxy Process Opens Door to Constructive Engagement on Climate." (Morningstar) https://www.morningstar.com/articles/945007/proxy-process-opens-door-to-constructive-engagement-on-climate.
[8]Welsh, H., & Passoff, M. 2019. "Proxy Preview 2019." (As You Sow; Sustainable Investments Institute; Proxy Impact) P. 50-58. https://static1.squarespace.com/static/59f0ef404c326d3b5a4cf6a0/t/5cf59ad1c0080d0001ad04de/1559599845734/AYS-ProxyPreview20190603+Final.pdf.
[9]Ibid, P. 34-44.

Just recently, BlackRock CEO Larry Fink acknowledged that "climate risk is investment risk" and that this is "a risk that markets to date have been slower to reflect."[10] He noted that "awareness is rapidly changing…evidence on climate risk is compelling investors to reassess core assumptions about modern finance. Research from a wide range of organizations–including the UN's Intergovernmental Panel on Climate Change, the BlackRock Investment Institute, and many others, including new studies from McKinsey on the socioeconomic implications of physical climate risk–is deepening our understanding of how climate risk will impact both our physical world and the global system that finances economic growth."[11] This statement aptly demonstrates the dilemma for investors: They can update their views about risks only as new information from a variety of organizations becomes available. Stifling their voice based on arbitrary criteria fails to permit them to benefit the market and corporate governance with their improved understanding.

As the Commission itself recognizes, shareholder proposals to date have not been too numerous or too costly. The number of shareholder proposals submitted to companies in 2018 was 831.[12] The number of submitted shareholder proposals has fluctuated from a low of 745 in 2001 to a high of 1,136 in 2008.[13] The annual cost for permitting these proposals is estimated to be around $137,000 per company, an amount less than these companies often spend on the salary of one employee.[14] We believe this figure is inflated, given the discretion that companies have in how much to spend opposing a shareholder resolution. Even so, all Russell 3000 companies together would experience annual cost savings of only up to $70.6 million per year from this proposal.[15] Market fluctuations in stock pricing that can result from mispricing ESG risks are often far higher than this value.

Deterring shareholders from acting on their concerns about ESG risks is harmful to the market and to what would otherwise be a low-cost investment in corporate governance. We do not believe these numbers indicate that there is any problem for the Commission to solve. None of the evidence provided indicates that the burden is too great for corporations, and the benefit of shareholders having a voice is tremendous.

[10]Fink, L. 2020. "A Fundamental Reshaping of Finance." (BlackRock) https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter?cid=ppc:CEOLetter:PMS:US:NA&gclid=EAIaIQobChMIpfWP2uiS5wIViLzACh0pPwAUEAAYASAAEgItZPD_BwE&gclsrc=aw.ds.
[11]Ibid.
[12]Proposed Rule, P. 66476.
[13]Proposed Rule, P. 66476.
[14]Proposed Rule, P. 66496.
[15]Proposed Rule, P. 66502.

II. Shareholder Resolutions Spark Dialogue

Shareholder proposals serve multiple purposes. Even when they do not receive majority support, they serve to draw attention to an issue and start a dialogue between shareholders and companies around a variety of issues. There is broad agreement that shareholder resolutions trigger dialogue. As one governance expert puts it, "proposals, even those that failed to get on the proxy, have led to increased dialogue between companies and shareholders in recent years as submissions on environmental and social issues grew."[16] Justin Danhof, "a conservative shareholder advocate," asserted that "filing a proposal is an opening, to encourage discussion, and it can lead to truthful negotiations to advance the issues [shareholders are] focused on."[17]

The impact of shareholder resolutions can even be seen through their ability to change the views of management. For example, in the case of GEO Group, shareholder resolutions regarding the use of prison labor in its supply chain ultimately succeeded in convincing company management to change their view from recommending against a proposal that would require the company to report annually on how it implements its own human rights policy, to supporting the proposal.[18] GEO Group stated that "based on our continued shareholder engagement efforts and the status of our planning efforts, our position has evolved. As a result,…our Board is withdrawing its original recommendation to the shareholders to vote against [the proposal]."[19] This shareholder proposal preceded class action lawsuits naming GEO Group for mistreatment of prisoners and detainees.

Even proposals that have not received majority support can bring about change. Change often occurs through asset manager engagement with companies on ESG issues. While asset managers may not always vote in favor of shareholder resolutions, their engagement efforts are influenced by the resolutions on the ballot. As we have previously written, asset manager engagement can often facilitate an opening for a dialogue with corporate management over corporate governance and other concerns.[20] As acknowledged by a large asset manager, shareholder proposals act "as a tool to

[16]Lemos Stein, M. 2018. "Gadfly Pushes Conservative Spin to Shareholder Resolution." *The Wall Street Journal*. https://www.wsj.com/articles/gadfly-pushes-conservative-spin-to-shareholder-resolutions-1523812814.
[17]Ibid.
[18]The GEO Group. 2019. "Shareholder Proposal Regarding an Annual Human Rights Report." https://www.sec.gov/Archives/edgar/data/923796/000119312519090420/d691911ddef14a.htm#toc691911_1.
[19]Zoley, G.C. 2019. "Annual Meeting Letter to Shareholders." (The GEO Group) P. 2. https://www.sec.gov/Archives/edgar/data/923796/000119312519119626/d718922ddefa14a.htm (Letter to Shareholders).
[20]Cook, J., & Sethi, J. 2019. "Asset Managers as Stewards of Sustainable Business: Implications of the Rise in Passive Investing." (Morningstar) P. 6. https://www.morningstar.com/blog/2019/10/09/global-stewardship.html.

signal investor concern to companies about emerging issues and/or as a catalyst for engagement."[21] Shareholder proposals enable the identification of issues–such as ESG concerns–that are material to the "long-term financial sustainability" of a company.[22]

In some cases, engagement that results from a shareholder resolution leads to an agreement between shareholders and management that ultimately allows the resolution to be withdrawn before it gets to the ballot. In 2018, more ESG resolutions were withdrawn through engagement than appeared on corporate ballots.[23] Most withdrawn resolutions addressed gender pay equity, board diversity, carbon asset risk, equal employment opportunity reporting, and money in politics.[24] The most recent proxy season saw high-profile withdrawals of shareholder resolutions, which signals successful engagement between investors and companies following resolution filing. These resolutions included requests for companies to set greenhouse gas emission reduction targets and disclose business strategy implications on the Paris Climate Agreement.[25]

Shareholders have used the proxy process to shape governance practices for almost 80 years.[26] Continuing to enable the proxy process is key to raising awareness of issues that pose material investment risks to portfolios and the equities market. The value of shareholder proposals extends beyond the vote itself to encompassing the common benefits that occur through dialogue and engagement with companies.

III. The "Cooling-Off" Period Precludes Proposals That Enjoy Swings in Support Based on New Information and Current Events

The Commission expresses a concern that shareholder resolutions enjoying low levels of support will be brought "year after year," burdening company resources with the "repeated consideration of these proposals and/or their recurrent inclusion in the proxy statement."[27] In order to address this concern, the Commission sets a five-year minimum for resubmission thresholds and a three-year "cooling-off" period for

[21]Novick, B., et al. 2018. "The Investment Stewardship Ecosystem." (BlackRock) P. 9. https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf.
[22]Ibid, P. 7.
[23]Cook, J. 2019. "The Proxy Process." (Morningstar) P. 16. https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/The_Proxy_Process__Raising_the_Investor_Voice_to_Address_New_Risks.pdf?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=16311 (Proxy Process).
[24]Ibid.
[25]Cook, J. & Sethi, J. 2019. "Asset Managers as Stewards of Sustainable Business: Implications of the Rise in Passive Investing." (Morningstar) P. 6. https://www.morningstar.com/blog/2019/10/09/global-stewardship.html.
[26]Proxy Process, P. 19.
[27]Proposed Rule, P. 66470.

proposals enjoying between 25% and 50% in support that have experienced a 10% decline in support.[28]

We are concerned that the Commission fails to recognize that large increases in support can occur as a result of current events, such as shareholder resolutions regarding gun violence after mass shootings,[29] or on the basis of new information, such as shareholder resolutions regarding climate change resulting from new data on its global impact.[30] Shareholder resolutions also take time to gain support but are often quite prescient–for example, shareholder resolutions as far back as 2004 addressed predatory lending practices at Wells Fargo.[31] A three-year cooling-off period based on the percentage support a resolution enjoys does not allow investors to voice their concerns at points in time when new information about corporate actions or evidence of investor impact comes to light.[32] It also does not allow shareholders to build support over time and educate the market regarding the risks about which they are concerned.

Our data analysis demonstrates that very large swings in support can occur in just one year. Levels of support for resolutions for proxy access bylaws in a large technology company and a multinational delivery service jumped as much as 59 and 51 percentage points, respectively, by the next submission between 2014 and 2015. The 2015 and 2016 proxy seasons were watershed years for the number of resolutions filed and the average support for resolutions on proxy access, resulting in widespread adoption of this measure by S&P 500 corporate boards. 70% of these boards now have proxy access provisions in their bylaws.

In another instance, a gender pay equity proposal at a large e-commerce company increased from 8% to 51% from 2015 to 2016. After the 2016 vote, the company issued a gender pay equity study showing it had achieved near pay parity between women and men, joining ranks with other technology companies that had issued their reports earlier in 2016.

Additionally, a resolution asking the board to disclose efforts to prevent prison labor in the supply chain at a department store corporation jumped 30 points in one year. This large swing in support from 2018 to 2019 results from a focus on the issue of fair

[28]Proposed Rule, P. 66507, 66515.
[29]For instance, shareholder activists submitted a proposal calling for a commitment to human rights on a firearm manufacturer's ballot in 2019 after two mass shootings earlier that year in El Paso, TX and Dayton, OH. Duprey, R. 2019. "Activist Investors Want Smith & Wesson Owner to Tackle 'Human Rights Impacts.'" (Motley Fool) https://www.fool.com/investing/2019/08/24/activist-investors-want-smith-wesson-owner-to-tack.aspx.
[30]For instance, following the signing of the Paris Climate Agreement by a majority of countries in 2015, a 2016 resolution on a multinational gas and oil corporation's ballot called for regular disclosure of the risk from global warming to the corporation's portfolio. Proxy Process, P. 13.
[31]Kovacevich, R. 2004. "Wells Fargo Annual Meeting Notice to Shareholders." (Wells Fargo & Company) https://www.sec.gov/Archives/edgar/data/72971/000119312504045640/ddef14a.htm#toc.
[32]Proposed Rule, P. 66472.

prison labor policies at other companies, such as GEO Group[33] and increasing international legislation on modern slavery, including in Australia, the UK, and Canada.[34]

Thus, support for a proposal in one year is a poor indicator of future support for a shareholder resolution. Consequently, the Commission's belief that such resolutions would simply waste corporate resources if resubmitted because it is "doubtful that the proposal will earn the support of a majority of shareholders in the near term"[35] is not substantiated.

IV. The "Substantially the Same" Requirement, Together with the Momentum Requirement, Can Preclude Meritorious Proposals Through Gaming

We are also concerned about the Commission's requirement that proposals dealing with "substantially the same" subject matter as previous proposals can be disqualified.[36] This disqualifier could allow proposals that have distinct intentions–for example, diversity based on race and ethnicity versus diversity based on ideology–to be considered substantially the same. Academic research has linked the rise in diversity proposals based on cognitive and experiential factors (instead of demographics) to a decline in gender and racial diversity on boards and in management.[37] Shareholders have become informed on diversity and Morningstar estimates that "ideological diversity" proposals received only 1.7% support during the 2019 proxy season. If the Commission's proposal were to become final, this low level of support could harm the prospects of diversity proposals that are far more effective at addressing gender, racial, and ethnic board imbalances. These low levels of support may disqualify diversity proposals by the Momentum Requirement. Interestingly, the Sustainable Investments Institute found that the Momentum Requirement would have had an impact on 13 ESG proposals since 2010.[38] If these proposals are perceived as substantially the same as proposals focused on gender and race diversity, then they could not be resubmitted until after the cooling-off period.

[33] Letter to Shareholders, P.2.
[34] Binder, N. 2019. "Modern Slavery Compliance for U.S.-based (and Other) Multinationals: A Review of Recent Compliance and Disclosure Developments in the United States and Abroad." (JD Supra) https://www.jdsupra.com/legalnews/modern-slavery-compliance-for-u-s-based-18572/.
[35] Arjuna Capital. (2016). "Arjuna Capital Applauds Ebay Closing Gender Pay Gap, Making It 6th Company to Respond to Shareholder Campaign Targeting Silicon Valley." (Arjuna Capital) http://arjuna-capital.com/news/arjuna-capital-applauds-ebay-closing-gender-pay-gap-making-6th-company-respond-shareholder-campaign-targeting-silicon-valley/.
[36] Proposed Rule, P. 66473.
[37] Geletkanycz, M., Clark, C.E., & Gabaldon, P. 2018. "When Boards Broaden Their Definition of Diversity, Women and People of Color Lose Out." *Harvard Business Review*. https://hbr.org/2018/10/research-when-boards-broaden-their-definition-of-diversity-women-and-people-of-color-lose-out.
[38] ESG Resolutions, P.1.

In summary, we believe that shareholder resolutions spark dialogue rather than burden corporations. We recommend that the Commission eliminate the "cooling-off" period. We further recommend that the Commission clarify the "substantially the same" subject matter requirement to minimize gaming and eliminate the Momentum Requirement, as we see no compelling need for it.

We thank the Commission for the opportunity to comment on the proposed rule. Should you wish to discuss any of the comments in this letter, please do not hesitate to contact any of us as indicated below:

Aron Szapiro at [redacted] or [redacted]
Jasmin Sethi at [redacted] or [redacted].
Jackie Cook at [redacted] or [redacted].

Sincerely,

Aron Szapiro
Director of Policy Research, Morningstar, Inc.

Jasmin Sethi
Associate Director of Policy Research, Morningstar, Inc.

Jackie Cook
Director of Investor Stewardship Research, Morningstar, Inc.