ES158996

United States Senate
WASHINGTON, DC 20510

March 4, 2020

The Honorable Jay Clayton
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Chair Clayton:

We write to comment on two recent rule proposals by the Securities and Exchange Commission (SEC or Commission): Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-87457, File No. S7-22-19 (Proxy Voting Proposal)[1]; and Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Release No. 34-87458, File No. S7-23-19 (Shareholder Submission Proposal, and collectively, the Proposals).[2] The Proposals would substantially restrict shareholder rights and limit corporate accountability. Rather than furthering the SEC's investor protection mission, the Proposals take the side of companies instead of shareholders and could have the unintended consequence of discouraging investment. Substantial elements of both Proposals should be changed to protect investor rights, keep corporate management accountable, and preserve the appeal of American capital markets.

The Proposals follow the SEC's November 2018 Roundtable on Proxy Issues (Proxy Roundtable).[3] At that event, market participants identified the dysfunctional mechanics of how shareholders vote shares and how companies tabulate votes as the area most needing the SEC's focus.[4] Instead, the Commission ignored what it should have learned from the Proxy Roundtable and embarked on significant changes to the work of proxy advisors and the shareholder proposal requirements.

The Proposed Amendments to the Proxy Rules Benefit Companies to the Detriment of Shareholders

Although the Commission states it is seeking to improve the accuracy and transparency of disclosure provided by proxy advisory firms and reduce errors, the Proxy Voting Proposal would

[1] Proxy Rules for Proxy Voting Advice, Release No. 34-87457; File No. S7-22-19 [hereinafter Proxy Voting Proposal], https://www.sec.gov/rules/proposed/2019/34-87457.pdf.
[2] Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Release No. 34-87458; File No. S7-23-19 [hereinafter Shareholder Submission Proposal], https://www.sec.gov/rules/proposed/2019/34-87458.pdf.
[3] U.S. Securities and Exchange Commission, Roundtable on the Proxy Process, Nov. 2018 [hereinafter Proxy Roundtable], https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf.
[4] *See*, Proxy Roundtable.

go well beyond those goals by changing the way proxy advisory firms do their work and impairing the service provided to institutional investors.

Institutional shareholders use proxy advisors for a range of services, including preparing standardized research reports based on company filings and managing the voting process. As noted in the Proxy Voting Proposal, institutional investors own between 70 and 80 percent of the market value of U.S. public companies,[5] and "investment advisers voting on behalf of clients and other institutional investors . . . must manage the logistics of voting in potentially hundreds, if not thousands, of shareholder meetings and on thousands of proposals."[6]

At both the Proxy Roundtable, and the Senate Banking Committee Hearing titled: Proxy Process and Rules: Examining Current Practices and Potential Changes held in December 2018,[7] we heard from institutional investors who select and hire proxy advisory firms about the importance of those services and their concerns with potential additional regulation. They were right to be concerned—the Proxy Voting Proposal goes far beyond what is necessary to improve conflict disclosure or achieve accurate proxy voting advice.

As the Assistant Comptroller, Corporate Governance and Responsible Investment in the Office of the Comptroller of New York City summarized at the Banking Committee Proxy Process hearing, "[i]n our view, additional regulation of proxy advisors would likely increase our cost and delay our receipt of research, with no clear benefit to our process."[8] The institutional investors at the Proxy Roundtable were also clear when they stated that, "it has not been our experience that there is a compelling need for additional regulation,"[9] and "we find a small, very small, number of objective factual errors, and we think those are dealt with and need to be dealt with."[10]

The SEC fails to make a credible argument that errors in proxy advisor reports justify the proposed rule changes, and the data cited by the SEC on errors by proxy advisory firms raises alarming questions. We agree with the SEC Investor Advisory Committee that the Proxy Voting Proposal does not establish the need for such burdensome regulation to address errors in proxy advisor reports. For example, the Proxy Voting Proposal states there were over 17,000 shareholder votes in a three-year period from 2016 to 2018, but companies filed only 260 supplemental proxy statements claiming errors by proxy advisors. Of the 260, the SEC classified only 54 as "factual errors" and none of them as material or affecting the outcome of a vote,[11] without further elaboration.

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[5] Proxy Proposal at 7.
[6] *Id.*; the Proxy Proposal notes 5,862 registrants filed proxy materials in 2018, Proxy Voting Proposal at 95.
[7] *Proxy Process and Rules: Examining Current Practices and Potential Changes, Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 115th Cong. (2018).
[8] *Id.*
[9] Proxy Roundtable transcript at 238 (comments of Ms. Patti Brammer, Ohio Public Employees Retirement System.
[10] Proxy Roundtable transcript at 238 (comments of Mr. Jonathan Bailey, Neuberger Berman).
[11] Recommendation of the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee, Relating to SEC Guidance and Rule Proposal on Proxy Advisors and Shareholder Proposals (Jan. 24, 2020),

Yet, to address proxy advisor errors, the Proxy Voting Proposal overreaches by providing companies with two separate opportunities to review proxy advisor reports before the investors that paid for them have an opportunity to read these reports. The proposed rule also would allow companies more time to review proxy advisor reports the earlier they file the definitive proxy statement, providing as many as five business days for a proxy statement filed more than 45 calendar days in advance.[12] In all cases, the Proxy Voting Proposal would allow companies another review of the proxy report for no less than two business days prior to final issuance. In total, a company could conceivably have as many as eleven calendar days to review a proxy advisor report before an investor gets it.

The SEC's stated intent is to create "enhanced engagement between proxy voting advice businesses and registrants,"[13] but the Proxy Voting Proposal creates obvious and needlessly burdensome obstacles forcing investors to wait longer for the reports they have paid to receive. In addition, this Proposal would create a problematic conflict of interest because companies now have the opportunity to interject their opinion into proxy advisors' analysis. This advance review makes as much sense as requiring a teacher to let a student review and negotiate her report card not once but twice before she has to take it home.

By any measure, the time periods provided to companies for review are a substantial portion of the period proxy advisors have to prepare reports for their clients. For example, to put those periods in context, a definitive proxy statement filed 25 *calendar* days[14] in advance on March 2, 2020, for a shareholder meeting on March 27, 2020, would require a proxy advisory firm to give the company a total of five *business* days for review and feedback on the final proxy report. That amounts to 26% of the 19 business-day window between filing of the proxy and the annual meeting. This review and feedback adds to the challenge faced by proxy advisory firms that in that period must review, digest, and prepare reports based on the proxy statement filed by the company.

Ultimately, the Commission plainly failed to heed the clear message of professional investors that, "any regulation that is considered needs to bear in mind the additional cost that may be leveled on that, which would hit the savers and investors on whose behalf we manage money."[15] Specifically, the mandatory review process in the proposed rule would be overly burdensome, unnecessarily interposes companies between proxy advisory firms and their institutional investor clients, and threatens the independence and completeness of proxy advisor reports. It should be eliminated in the final rule.

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https://www.sec.gov/spotlight/investor-advisory-committee-2012/sec-guidance-and-rule-proposals-on-proxy-advisors-and-shareholder-proposals.pdf.

[12] Proxy Proposal at 46; companies filing definitive proxy statements between 45 and 25 calendar days in advance would have a three business day feedback period, and those filing less 25 calendar days in advance would have no feedback period.

[13] Proxy Proposal at 43.

[14] This period comprises 19 business days.

[15] Proxy Roundtable transcript at 251-52 (comments of Mr. Jonathan Bailey, Neuberger Berman).

The Proposed Changes to the Shareholder Submission Proposal and Resubmission Requirements Disenfranchise Mom and Pop Investors and Allow Company Management to Avoid Important Shareholder Concerns

The Shareholder Submission Proposal would make troubling changes to the shareholder proposal requirements, denying many Mom and Pop investors the opportunity to submit proposals for a vote by all of a company's shareholders. The proposed changes to the initial ownership levels for filing a proposal and to the resubmission thresholds would mean small shareholders effectively lose the ability to raise corporate governance concerns.

The proposed rule would raise the current ownership requirement from $2,000 of stock held for one year to $25,000—essentially taking away the existing one-year holding option from non-wealthy investors. Instead, the proposed rule would require investors with $2,000 of stock to hold it for three years to be able to submit a proposal, preventing many Mom and Pop investors from communicating with other shareholders. These proposed changes are not only anti-shareholder, but they are particularly concerning because they discriminate against the non-wealthy investors that this Commissions claims are priorities.[16] Instead of further de-democratizing the ability of shareholders to participate fully in the corporate governance process, the SEC should be helping shareholders, especially retail investors, share valuable ideas with other investors and with management.

Shareholders' right to submit proposals has long been a key component of stock ownership[17] and has played a key role in holding executives accountable and initiating and advancing changes that create long-term benefits for shareholders, companies, and other stakeholders. For example, in recent years, investors have successfully used shareholder proposals to prompt over a dozen opioid manufacturers and distributors to improve compliance and governance risks related to the sale of the drugs.[18] Shareholders have also used proposals to ask companies to disclose their gender pay gaps. Over the past five years, investors have refined those proposals to obtain more detailed and comparable information on gender pay disparities across multiple industries.[19]

Shareholder proposals have also served as a driving force for greater corporate awareness, and voluntary disclosure, of environmental and social risks, such as climate change risk management, and sustainability reporting. Indeed, since 2009, shareholder proposals have been key to the increase in sustainability reporting among S&P 500 companies—as of 2018, 86% of S&P 500 companies provided sustainability disclosure.[20] In a letter to clients earlier this year, the CEO of BlackRock explained the continued need to improve sustainability disclosure, "[g]iven the

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[16] *See*, Shareholder Submission Proposal.
[17] SEC Rule 14a-8 dates back to 1942.
[18] https://www.iccr.org/sites/default/files/page_attachments/ioa_two_year_summary_report.pdf.
[19] https://corpgov.law.harvard.edu/2019/03/22/new-developments-in-shareholders-gender-pay-gap-proposals/.
[20] Flash Report: 85% of S&P 500 Companies Publish Sustainability Reports in 2017 (Mar. 2018), https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html.

groundwork we have already laid and the growing investment risks surrounding sustainability, we will be increasingly disposed to vote against management when companies have not made sufficient progress."[21] As institutional investors focus on the sustainability of their investments, we expect shareholder engagement on environmental and climate issues to intensify and shareholder proposals to become even more important.

Each time a company enhances its disclosure or upgrades its corporate governance policies in response to a shareholder proposal, it reinforces the effectiveness of, and the benefits created by, shareholder proposals. Accordingly, the SEC has historically been thoughtful when considering the submission threshold. The SEC last raised the dollar value threshold from $1,000 to $2,000 in 1998 "to adjust for the effects of inflation since the rule was last revised." [22] The Commission stated in that rule, "although several do not believe the increase is great enough to be meaningful . . . we have decided to limit the increase to $2,000 for now, in light of rule 14a-8's goal of providing an avenue of communication for small investors."[23] Under the proposed rule, small investors would no longer have that avenue of communication—the $2,000 level from 1998 adjusted for inflation would be approximately $3,170[24] in today's dollars, well below the proposed level of $25,000.

Participants at the Proxy Roundtable highlighted the contributions of smaller investors in the shareholder proposal process, noting —"[t]he marketplace for good ideas is not limited to large institutional investors,"[25] and "the beauty of shareholder democracy is that the quality of one's idea doesn't depend on the size of one's ownership."[26] Similarly, the Senate Banking Committee heard at its Proxy Process hearing that, "large institutional investors do not have a monopoly on good ideas. In our view, shareowners of any size should have the opportunity to use the shareowner proposal process."[27] Based on the Shareholder Submission Proposal, the SEC does not agree and seems to be moving in the opposite direction, making it harder for smaller investors to participate in the shareholder proposal process.

In addition to shutting out small investors, the increase in the resubmission thresholds required to submit proposals in future years could silence the debate and consideration of important issues,

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[21] Letter to Clients, Laurence Fink, Chief Executive Officer, BlackRock, Inc., Sustainability as BlackRock's New Standard for Investing (Jan. 14, 2020), https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter.
[22] Amendments to Rules on Shareholder Proposals, 63 Fed. Reg. 29,106 (1998), https://www.sec.gov/rules/final/34-40018.htm.
[23] *Id*.
[24] Calculated using the Bureau of Labor Statistics CPI inflation calculator, at https://data.bls.gov/cgi-bin/cpicalc.pl.
[25] Proxy Roundtable transcript at 141 (comments of Mr. Brandon Rees, American Federation of Labor and Congress of Industrial Organizations).
[26] Proxy Roundtable transcript at 151-52 (comments of Mr. Jonas Kron, Trillium Asset Management).
[27] *Proxy Process and Rules: Examining Current Practices and Potential Changes: Hearing Before the Committee on Banking, Housing, and Urban Affairs*, 115th Cong. (2018) (statement of Mr. Michael Garland), https://www.banking.senate.gov/hearings/proxy-process-and-rules-examining-current-practices-and-potential-changes.

even though most proposals gain greater acceptance in subsequent years.[28] In a further effort to undermine shareholders, the Shareholder Submission Proposal introduces a "momentum requirement"—an additional mechanism to limit proposals in future years. That provision would exclude proposals that meet the new, highest resubmission threshold, but which receive 10% fewer votes than the prior year.[29]

Research from former Commissioner Robert Jackson's office showed that the proposed resubmission thresholds would have eliminated many corporate governance proposals from consideration in later years. Specifically, the research found more than 65% of proposals for better reporting on climate change would have been excluded in subsequent years, as would 50% of board diversity proposals and 40% of political spending disclosure.

You have held yourself out as an advocate for small investors and testified before Congress that, "[o]ur first goal is to focus on the long-term interests of Main Street investors."[30] You have also referred to our capital markets as a "democratizing force in our society."[31] Unfortunately, the Shareholder Submission Proposal's potential to disenfranchise small shareholders contradicts your claims and would be contrary to the long-term interests of Mom and Pop investors.

The Commission must thoroughly reconsider the Shareholder Submission Proposal with a more balanced approach that also prioritizes the interests of Mom and Pop investors. If the proposed higher ownership levels for shareholder proposals result in fewer rights for small shareholders, the Commission will have failed a crucial part of its mission because the Commission should be protecting the rights of investors of all sizes to engage with the companies they own. Indeed, expanding shareholder participation makes our markets more efficient and creates confidence that the markets can work for everyone.

In conclusion, the Shareholder Submission Proposal would deny Mom and Pop shareholders the ability to communicate with their fellow shareholders and easily participate in corporate governance unless they meet unjustifiably high thresholds that only wealthy investors can meet. Our capital markets are strong in large part due to the broad participation of all investors, especially Mom and Pop investors, and the SEC should be working to increase broad investor participation instead of needlessly increasing the burden on smaller investors with additional hurdles to hold management accountable.

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[28] The current resubmission thresholds of 3%, 6%, and 10% of votes cast for proposals voted on, respectively, once, twice, or three or more times in the last five years would be increased to thresholds of 5%, 15%, and 25%, respectively.

[29] Shareholder Submission Proposal at 58.

[30] *Oversight of the Securities and Exchange Commission: Hearing Before the Committee on Banking, Housing, and Urban Affairs, the Oversight of the Securities and Exchange Commission*, 116th Cong. (2019) (statement of SEC Chair Jay Clayton), https://www.banking.senate.gov/download/12/09/2019/clayton-testimony-12-10-19.

[31] https://www.sec.gov/news/speech/speech-clayton-2018-05-02

In a May 2, 2018, speech, you stated, "A word of caution: It is easy to take this powerful dynamic for granted, that it's preordained that our markets invite, and benefit from, broad participation. It is not preordained, and we should not take it for granted."[32]

We could not agree more, and for all of the reasons stated, we respectfully urge the Commission to withdraw the Proposals and evaluate how better to protect shareholders, especially Mom and Pop investors.

Sincerely,

Sherrod Brown
U.S. Senator

Jack Reed
U.S. Senator

Brian Schatz
U.S. Senator

Richard J. Durbin
U.S. Senator

[32] https://www.sec.gov/news/speech/speech-clayton-2018-05-02