Recommendation of the Investor-as-Owner Subcommittee of the
SEC Investor Advisory Committee (IAC)
Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals

(January 16, 2020)

This recommendation addresses recent SEC actions regarding the proxy system, including two guidance documents and two rule proposals (the **PA/SP actions**).[1] The Investor Advisory Committee (**IAC**) shares the Commission's interest in revisiting the voting system as practices and participants have evolved over time. Periodically reviewing whether SEC oversight is aligned with market practices helps assure that investors are well protected. The PA/SP actions, when viewed together, will affect the rights and opportunities of investors to engage effectively in the governance of the companies in which they invest.

The IAC has long urged the Commission to address a variety of problems in the proxy system, and there are valuable elements in the PA/SP actions, such as improved disclosure on proxy advisor conflicts of interest.[2] While we appreciate the Commission's effort to seek a productive balance in a changing environment for corporate governance and shareholder engagement, we are concerned the PA/SP actions may collectively shift the balance in a manner that does not serve investor interests.

We believe the PA/SP actions as currently framed will not reliably achieve their stated goals, because the system is in need of more basic reform, and because it is necessary to establish a link between the actions and clearly identified problems. Finally, we believe that reasonable alternatives deserve consideration.

We urge the Commission to consider the following questions and points in assessing next steps in this area.

- What will the **cumulative impact** of these initiatives be on investors, and what is the potential for unintended consequences of the combined actions? In particular, the Commission should ensure that it has a good understanding of the impact of these initiatives on small and mid-sized market participants, and ensure that it will not result in unjustified additional burdens and costs on small and mid-sized asset managers that will impair their ability to perform their responsibilities to clients.
- Will the proposals preserve the critical role that proxy advisory firms play in the dissemination of information and in providing the **practical machinery** of proxy voting for the vast majority of shareholders (through their representatives)? These services are essential to the smooth functioning of shareholder engagement in governance and are not dependent on recommendations or advice on how to vote on specific matters. As discussed more below, we recommend the Commission further evaluate the impact these initiatives may have on the market for proxy advisory services. There is a risk the proposals could impair the ability of proxy advisors to sustain their businesses, and deter new competitors to enter the business, which could result in increased monopoly power and more – not fewer – one-size-fits-all voting outcomes.
- Are the proposals tightly linked to **clearly identified problems**, and are there **better alternatives**? As detailed below, we recommend a focus on the economic analysis in the releases and a presentation of the specific proposals to ensure they meet the Commission's stated objectives. In doing so the Commission may be better positioned to develop a broader range of alternatives that may be more likely to achieve the stated goals of the proposals at a lower net social cost.

More specifically, we make three overall recommendations:

- **Revisit Priorities**. We reiterate our belief that the PA/SP actions simply do not address the most serious issues in the current proxy system – such as **counting votes correctly**. We believe it critical

that the SEC take up end-to-end vote confirmations, reconciliations, and universal proxies.* Despite inclusion in the SEC's overall proxy system agenda, despite our previous recommendations, no formal guidance or rulemaking regarding proxy plumbing yet have been published by the SEC, and the SEC has not moved to finalize its good 2016 proposal on universal proxies.

- **Revise and Republish the Rule Proposals for Balance and Compliance with SEC Guidance**. The SEC should revise and re-issue the rule proposals to:
    - Present a balanced assessment of proxy advisors and shareholder proposals.
    - Comply with SEC guidance on the economic analysis included in the releases.
    - Present evidence supporting the need for the proposals, rather than stating simply that problems "may" exist.
    - Address reasonable alternatives to the proposed changes and why they are not more likely to achieve the stated goals of the proposals at a lower net social cost.
    - More fully address how the PA/SP actions particularly affect small and mid-sized investment managers and "Main Street" shareholders.
    - Discuss the risk that the proposals could impair the ability of proxy advisors to sustain their businesses, or new competitors to enter the business, which could result in increased monopoly power and more – not fewer – one-size-fits-all voting outcomes.
- **Reconsider the Guidance**. As the guidance documents did not go through a notice-and-comment process, they did not reflect the input that the rule proposals are now eliciting from knowledgeable stakeholders. They have generated confusion among many investors, and should be reconsidered in the context of revised rule proposals that respond to the above recommendations.

1. Revisit and establish priorities in improving the proxy system

We reiterate our belief that what is wrong with the current proxy system – such as challenges that currently exist to counting the votes correctly – are simply not addressed in the PA/SP actions. We continue to recommend that the SEC take up end-to-end vote confirmations, reconciliations, and universal proxies before spending more time on the PA/SP proposals. The basic plumbing for determining board elections is at the heart of the corporate governance system, and getting a reliable vote count on a timely basis affects all shareholders. These are foundational questions where there is a broad investor consensus that the system has basic problems. Yet to date, no SEC actions in these areas have occurred.

The challenges in remedying proxy plumbing are not simple. As we have previously noted, private actors have failed to implement reforms on their own for decades. We believe SEC action is necessary, and getting that action right will not be easy. For reasons we discuss below, the PA/SP actions involve questions that will require much more hard work to be made ready for adoption in a manner consistent with the statutory framework and with investor interests.

The proxy plumbing issues we have identified in the past are fundamental to the entire proxy voting system. If shareholders do not believe that the outcome of a vote accurately reflects their intent, changes to the role of proxy advisors would occur in the context of an unreliable system. Likewise, bearing in mind that the vast majority of shareholder proposal votes are non-binding, if the ability of shareholders to vote on those proposals is not reliable, this will lead to escalating conflict between shareholders and their fiduciaries, regardless of what shareholder proposal resubmission thresholds or limitations on proxy advisors the Commission seeks to adopt. The ability of the system to reduce agency costs and capital costs depends it

* Recommendation of the SEC Investor Advisory Committee (IAC) Proxy Plumbing September 5, 2019, available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-proxy-plumbing.pdf.

being accurate and resilient, and changes in the rest of the system will simply have less of an effect until that ability is established.

2. Improve conflict-of-interest disclosure generally

We agree that conflict of interest disclosure is important for all major participants in the securities markets, including proxy advisors. We note that the SEC already has in place such disclosure requirements, and commend the SEC for endeavoring to improve the quality of the disclosures that are actually made about conflicts of interest, as in the rule proposal on proxy advisors. As discussed below, however, we are unsure whether the first choice should be new rules, or should be better enforcement of existing rules. We also believe that any improvements made should not be limited to proxy advisors, but considered for other market actors, such as credit ratings agencies, broker-dealers, securities analysts,[3] corporate directors, and investment advisers. In general, we believe that investors need to be confident that when they seek advice that advice is objective and given with investors' interest in mind. As discussed more below, the draft rule appears to treat proxy advisors inconsistently with other advice providers and in a number of respects it could have the effect of creating unmanageable conflicts of interest by inserting the issuer in the advisory process.

3. Add a more balanced presentation of the value of proxy advisors and shareholder proposals

We commend the SEC for noting the value of proxy advisors and shareholder proposals, as when it states "We recognize that proxy voting advice businesses can play a **valuable role** in the proxy voting process,"[4] and that "institutional investors have found **efficiencies** in hiring these businesses to perform voting-related services, rather than performing them in-house."[5] With respect to shareholder proposals, the SEC correctly notes that "A shareholder proposal could be value enhancing not only because it could motivate a **value-enhancing change,** but also because it could **limit insiders' entrenchment** and **provide management with information** about the views of shareholders."[6] These statements are true and important.

Yet these statements about the value of proxy advisors and shareholder proposals make up 34 words each out of 107,000 words in the two rule releases. In the economic analysis of the releases, discussed below, there is no sustained description or analysis of the benefits of proxy advisors and shareholders, even though the SEC is required by law and its own guidance to discuss "costs" of the proposals to the baseline benefits of the regulated activity. This imbalance is notable given that SEC Commissioner Elad Roisman noted at the SEC's Proxy Roundtable that multiple panelists had clearly described "the role and importance that these firms [i.e., proxy advisors] provide to asset managers."[7] It is also notable given that the SEC's own guidance for economic analysis states that any release proposing a rule "should evaluate the costs and benefits even-handedly and candidly" and "frame costs and benefits neutrally and consistently."[8]

There is a marked contrast between lengthy recitation of problems that proxy advisors and shareholder proposals "may" create, on the one hand, and a negligible discussion of their benefits, on the other hand. The imbalanced presentation deprives the public of an adequate foundation for commenting on the proposals. The presentation fails to draw on the extensive discussion and evidence of the benefits of proxy advisors and shareholder proposals at the SEC's Proxy Roundtable, some of which we present below.

Annex A contains an overview of some benefits of proxy advisors and shareholder proposals as a starting point for a more balanced pair of revised proposed rule releases. We recommend inclusion of a more balanced presentation of the value of proxy advisors and shareholder proposals to the proxy system.

4. Comply with SEC guidance on economic cost-benefit analysis

Any SEC rule release should contain a cost-benefit (or "economic") analysis that complies with existing SEC guidance on rule proposals and case law cited in that guidance.[9] The PA/SP actions do not contain adequate

economic analyses, the most basic elements of which are outlined in this section.† Under the SEC's own guidance, and case law cited in that guidance, an economic analysis cannot simply be added in a final or adopting rule release to justify or rationalize a final approved rule. Rather, it should be contained in the proposing release to explain the need for the proposed rule.[10] This is so the public can understand the SEC's analysis and judgment, and provide comments on not simply the text of the proposed rule, but how well it matches identified purposes and how adequately the SEC's deliberations have been prior to rule proposals.

a. Identify clearly relevant market failures or other need for regulation

We recommend that the PA/SP actions clearly identify a market failure or other need for proposed rules. While there are various statements about what some corporate managers perceive to be "problems" in the current system, and therefore a "need" for improvements in the way voting advice is provided by proxy advisors, there is no statement as to why the SEC believes that the market – and private actors on their own – cannot satisfy that need on their own, or at least better respond to any such need than via a government mandate. Without a foundational component of economic analysis, the rule releases do not comply with the standards the SEC has sensibly set for itself. We recommend that the SEC revise and republish both rule proposals to clearly identify the market failures or other needs for regulation, so the public can evaluate the fit between the rule proposals and the market failure they are meant to address.

b. More fully set forth existing proxy advisor client protections as part of baseline

We endorse the idea in SEC's prior guidance that economic analysis should present a clear and complete statement of the relevant "baseline," the state of the world prior to adoption of the rule in question. In the case of proxy advisors, the proposing rule release is devoid of sustained analysis of the actual market affected by the proposed rule: the market for voting advice, in which existing legal protections are part of the relevant regulatory baseline. Proxy advisors have sophisticated institutional clients, who enter into contracts with the advisors, and are protected by state and federal laws against fraud. The rule releases identify no reason that traditional market pressures and self-help via contract and private enforcement of contract and tort law cannot do a better job of protecting the interests of proxy advisor clients than government-mandated regulations of the type proposed.

Relevant to the existing regulatory baseline are existing rules of the SEC. To extent the SEC believes the problem is with asset managers overly or recklessly relying on or failing to adequately consider conflicts in relying on proxy advisor recommendations, the SEC already has in place Rule 206(4)-6 of the Investment Advisers Act that requires investment advisers to have policies and procedures reasonably designed to ensure that they are fulfilling their fiduciary duties under state and federal law in respect of voting, including use of proxy advisors. The SEC has two divisions -- OCIE and Enforcement -- available to enforce duties and rules applicable to investment advisers. Nothing disclosed to the public suggests that OCIE or Enforcement is detecting widespread problems with investment advisers in respect of fulfilling their duties.[11]

The releases do not provide reasons why contracts, duties, rules and other legal protections are inadequate to protect the proxy system in the context of proxy advisors, which leaves us and the public in the dark as to the SEC's reasons for intervening here, but not in other parts of the proxy system. We recommend the SEC revise and republish the proxy advisor proposal to make clear why it thinks that the proxy advisor firm clients cannot use contract or rely on other protections at least as efficiently as the rule proposal's changes to guard against the problems that are said "may" exist (errors, conflicts of interest).

† Some members of the IAC would point out other limits or shortcomings in the economic analysis and in the paperwork analysis, but this recommendation leaves out those points both due to keep the recommendation shorter and because not all members view those additional points as appropriate for an IAC recommendation.

c. Cite reliable evidence of any material "problem" with proxy advisors‡

We recommend the SEC cite **evidence** of a problem of the kind that might be addressed by the key elements of the proxy advisor proposal – specifically, the part of the proposal mandating preclearance of draft reports with corporate managers and silencing advisors from speaking to their clients for at least a week[12] while managers review the reports. Instead, the SEC notes that some private interests, such as some corporate managers and their lawyers and trade group representatives, claim problems with proxy advisors exist, such as errors in advice given. The most the SEC says is that such problems "may" or "could" exist.

It is true the SEC cites to sources that assert that errors in proxy advisor reports exist. But a brief review of those sources shows that they provide no reliable basis for concluding material problems actually do exist, particularly problems that cannot otherwise be addressed by market responses, private action, contract, or heightened SEC of private enforcement of existing rules and duties. For example, the SEC states that

> concerns have been expressed …, particularly within the registrant [i.e., corporate manager] community, that there **could be** factual errors … in proxy voting advice businesses' analysis and information underlying their voting advice that **could** materially affect the reliability of their voting recommendations and **could** affect voting outcomes...[13]

In support, the only specific registrant source that the SEC cites is a letter from Exxon Corporation.[14]

In fact, however, the Exxon letter, fairly read, actually supports the opposite of the idea that there "could" be a significant number of material "factual errors" in proxy advisor reports. The Exxon letter candidly states that "**ISS traditionally has responded promptly to these sorts of errors** which are generally available in our proxy and could undermine client confidence in the quality control applied to ISS reports if left uncorrected." That is, Exxon thinks the largest proxy advisor already does a good job at fixing factual errors, and does so for market-driven reasons. By "these sorts of errors," Exxon makes it clear it means truly factual errors about which no reasonable person could in fairness view as a difference of opinion. (We discuss opinions and mixed fact/opinions below.)

No other source cited by the SEC to support the idea that more than a trivial number of factual errors "may" exist in fact show they exist, and none shows that **any** errors were material to the outcome of an actual shareholder vote.[15] SEC data – summarized later in the rule release[16] but undiscussed in the section that tries to outline the problems motivating the proposal -- show the number of factual errors is likely to be trivially small. From over 17,000 shareholder votes over three years, the number of possible factual errors identified by companies themselves in their proxy supplements amounts to **0.3%** of proxy statements – and **none** of those is shown to be material or to have affected the outcome of the related vote.[17]

	Data from SEC Proxy Advisor Proposal Table 2	**Number**	**As % of row 1**
1	Companies filing proxy statements 2016-2018	17,296	
2	Supplemental proxy statements filed by company managers claiming errors in proxy advisor reports	260	1.5%
3	Classified by SEC as "factual errors"	54	0.3%
4	Shown to be "material" errors	0	0.0%
5	Shown to affect outcome of vote	0	0.0%

Readers of the proxy advisor rule release would have benefited from some relevant baseline for what is possible for how error-free any complex analysis could realistically be expected to be. The SEC has available

‡ One member of the IAC does believe that issuer review of proxy recommendations is a good idea. Other members do not. All voting for the recommendation, however, recommend that the SEC revise and republish after considering and addressing the points made in the overall recommendation.

credit rating agency analyses[18] and security analyses by broker-dealers[19] that could have been compared for this purpose. The SEC presents no analysis of that kind, or any other method for the public or the SEC itself to evaluate the significance of the 0.3% error rate it reports for proxy advisor reports.[20]

The SEC also has available methods to test the factual basis for proxy advisor reports.[21] The SEC could survey investment managers who are the proxy advisors' clients, and ask if they have found uncorrected, material factual errors to be common, or indeed, ever a problem. (Indeed, the SEC did ask that kind of question at its Proxy Roundtable, discussed below, and has conducted similar surveys in the past.)

d. Distinguish between facts and opinions in evaluating the proxy advisor proposal

Economic analysis should be clear about what counts as a benefit, and distinguish problems that can be fixed by regulation from those that cannot. Exxon's letter, cited but not discussed by the SEC, makes an important point. Exxon states that "Ultimately, we do not believe it is productive to discussions of shareholder value to argue over whether any particular issue falls into the 'errors of fact' category or the 'difference of opinion' category." The reason Exxon declined to engage the question of how to distinguish fact and opinion is that it is in practice difficult. Yet for the SEC, the difficulty of distinguishing fact and opinion is a crucial fact for a public understanding of the most that the proposal could accomplish.

The dividing line between "fact" and "opinion" is itself the subject of opinion, as reflected in binding case law arising out of alleged misstatements or omissions by corporate issuers.[22] Some things are clearly facts – Exxon gives as an example "whether a biography correctly reflects a director's experience." Other things are clearly opinion – for example, whether a CFO's experience at one company is "adequate" for the job at another company. But many other claims fall in-between, consisting of a mixture of fact and opinion. In the in-between spaces, where judgment and fact mingle, one can expect reasonable people to reasonably disagree.

One recurrent "error" frequently identified as "factual" in corporate managerial sources cited in the SEC rule release are about choices of companies to include in **peer groups** for benchmarking companies against other companies. Peer groups are crucial for helping investors evaluate corporate performance and executive pay. Inappropriately chosen peer groups can make poor performance look good, and excessive or misaligned compensation look normal. Yet peer group formation is always clearly a mix of fact and opinion, since no two companies are ever precisely alike, and size and industry are often insufficient bases for selection of a clearly and objectively "best" group of peer comparisons. Investors are likely to benefit from hearing the views about appropriate peer groups from a proxy advisor, who is independent of managers, who have an obvious conflict of interest in selecting peer groups that are used in part to evaluate those same managers.

The fact that corporate managers may disagree with proxy advisors about peer groups, and about mixed fact/opinion judgments generally, is not an adequate basis for asserting there are enough "factual errors" to warrant SEC intervention. The very differences in such judgments are part of the value that independent advisors add to the proxy system, as discussed in Annex A below. By advancing their views about peer groups, proxy advisors create meaningful public discussion of such topics. Differences of this kind produce not "errors" but discussions. Differences of opinion are not the kinds of differences that a secret preview and comment period for corporate managers are likely to change. If they are the kinds of "errors" at which the rule proposal is aimed, the rule proposal is likely to impose costs without achieving any material benefit.

e. Relate proposal to its likely effects, which include that it will reduce speech, may bias speech, and create real or reasonably perceived threats to independence

If the proxy advisor rule proposal is adopted and works as intended – if the SEC in fact mandates that companies' managers get two shots in secret at converting proxy advisors to their points of view on questions of opinion and judgment – the result may be silencing or hiding of initial differences of opinion from the view of proxy advisor clients or the public, which should be considered as a cost, not a benefit, of the

proposed rule. The result may be not better speech, but less speech. Clients of proxy advisors will not get to see or hear the full back-and-forth exchange between advisors and companies.

If that happens, the effect would **not be viewpoint neutral** – the views that would be advanced would be those of corporate managers, not anyone else's views. The rule proposal cannot reasonably be expected to cause proxy advisors to revise initial opinions further **away from** or against those of corporate managers, because the only new information (except in a rare proxy contest) will be from managers and will favor managers. Peer groups will make performance look better, and executive pay look lower. To the extent proxy advisors draw an opinion out of a spectrum of plausible opinions, the rule proposal will push in one and only one direction – towards corporate managers. The result would be to bias the analysis.

The proxy advisor proposal requirement to share drafts with corporate managers are not limited to facts, for which one could imagine a useful role for companies to review. It covers everything: judgmental peer group selections, complex contestable application of analytical methods, and pure opinions. The requirement to share all opinions with one side of a debate in secret creates the obvious one-sided risk that proxy advisors will **lose their independence** (or be reasonably perceived to do so) by virtue of their routinely hearing directly from the patently self-interested and conflicted company directors before hearing from other market participants, including their own clients. Yet, as noted by one commenter, "**Management already gets 98.2% support for their board nominees**."[23] The proposal clearly risks increasing existing bias in debates about corporate managers and how well they are serving investors.

It is worth emphasizing in this context that the SEC-approved FINRA Rule 2241 explicitly **prohibits** securities analysts from sharing draft research reports with target companies (other than to check facts – and even then, only after approval from the firm's legal or compliance department, suggesting that even fact-checking is viewed as a potential threat to independence). This rule was designed explicitly to "help protect research analysts from influences that could **impair their objectivity and independence**."

We recommend that revised economic analysis acknowledge potential bias as a plausible cost of the rule, and consider alternative ways to the supposed problem the issuer-review proposal is meant to address.

f. Address trends and facts established at the SEC's Proxy Roundtable or stated in release

Economic analysis should be consistent and reflect known facts, including known trends. The proxy advisor release does not fairly reflect trends acknowledged by the SEC, or evidence from the Proxy Roundtable, neither of which support the idea that the SEC has identified a problem requiring regulation in this area.

To its credit, the SEC identifies positive trends in proxy advisor performance and held a Proxy Roundtable to gather information prior to issuing its rule proposals. But the rule release does not address those trends and evidence in its economic analysis. As the SEC states, "communication between proxy voting advice businesses and registrants may have improved over time," citing a 2016 GAO Report,[24] which cites evidence that "there has been a noticeable increase in outreach" by proxy advisors. At the Proxy Roundtable, an entire panel was devoted to proxy advisors, which included representatives of large and smaller companies (e.g., General Motors, Atlas Air), investment managers (e.g., Neuberger Berman, State Street), investors (e.g., Ohio Public Employees Retirement System), proxy advisors (e.g., ISS), academics and politicians. On that panel:

- a company representative noted "I do think disclosure [by proxy advisors of potential conflicts of interest] has gotten better"[25] and that "regulation could cause an increased cost that obviates the firms, which would not be the intention,"[26]
- an investment manager representative stated, "we don't feel that it needs to be regulated above and beyond what's currently taking place,"[27]

- a speaker from the American Enterprise Institute stated "we do not see the need for binding or quasi-binding regulation,"[28] and
- an investment owner representative stated "it has not been our experience that there's a compelling need for additional regulation."[29]

The panel's remarks were so consistently **contrary to the need for regulation** that an SEC staff member who was moderating the panel paused at one point to remark:

> I can't believe … Is there **anyone on the panel [who] thinks there should be additional regulation?** I haven't heard it yet, and I'm kind of surprised.[30]

The SEC cites evidence about improvements in proxy advisors, and in its fact-finding event heard no calls for regulation of proxy advisors. Yet it has now proposed to regulate, without considering that whatever problems exist are diminishing over time, and without providing any support for the need for regulation at all. If the trend is positive, and most informed observers are not calling for regulatory change, the SEC's rationale for proceeding at this time with a proposal on proxy advisors seems further unjustified.

5. Adequately consider reasonable alternatives to the proxy advisor proposal

We recommend more discussion of plausible alternatives to the proposed rules in its releases. With respect to proxy advisors, it notes seven.[31] Of the seven, however, only one (the last) is less restrictive or burdensome on proxy advisors or their clients. We recommend that the SEC develop and discuss a broader range of reasonable alternatives that are less restrictive or burdensome that might address the possible problems it says company managers perceive, such as conflicts of interest, or which might address those problems in a way that is more beneficial to public investors, as opposed to managers of public companies.

a. Status quo as alternative in economic analysis: the role of Rule 14a-9 and counter-speech

One example of such an alternative would simply be the status quo. With limited and carefully confined exceptions such as fraud and defamation, the normal way that false or incorrect statements are corrected in the U.S. is with more speech – so-called "counter-speech." The SEC has already taken the position in its summer guidance that proxy advisor reports are "solicitations" subject to the antifraud requirement of Rule 14a-9, and this would not change as a result of the rule proposal. Whether true or not, it is the status quo on which the SEC relies. Only "errors" short of fraud can fairly be said to be the target of the rule proposal.

As noted above, companies already file proxy supplements challenging proxy advisor opinions and even allege factual errors. Those are examples of "counter-speech," and the SEC offers no basis for concluding they are not effective at combating any errors in proxy advisor reports. While some shareholders may vote prior to these supplements, proxies are nearly always revocable until the shareholder meeting, so shareholders – if indeed they are persuaded wrongly at first by proxy advisors and then change their minds based on proxy supplements – can always withdraw their initial proxy and re-vote in favor of management. Again, the SEC provides no reason or evidence to show that this process is not adequate to keep voting outcomes in line with what would occur but for the small number of possible factual errors that affect outcomes to begin with.

b. Limit requirement to share reports with company managers to facts only

A second example of an alternative not discussed by the SEC would be to limit the requirement to share draft reports with corporate managers to "facts" and not opinion or mixed fact/opinion statements. This would have the benefit of at least confining the speech-limiting effect of the rule to a category that plausibly could produce useful improvement for investors. This alternative would impose fewer costs and limit the potential bias and reduction in independence of proxy advisors that the actual proposal creates. If the SEC were to take up this alternative, it should not simply do so in a final rule release, because the economic analysis –

which the public should and is entitled to review as part of the notice-and-comment process – does not currently embrace or support this alternative.

c. Publish draft reports rather than prevent proxy advisors from speaking to clients

A third example of an alternative not analyzed by the SEC that would have less risk of biasing proxy advice would be to require proxy advisors to disclose a draft of their reports or recommendations to company managers simultaneously with or somewhat after they disclose them to proxy advisor clients, and to impose a waiting period before clients subject to the SEC's jurisdiction could act on the advice or recommendations. This alternative would give company managers time to respond or correct errors, or argue for changes in opinions, before the public received the reports, and before asset managers acted on the reports. This alternative would be similarly burdensome on proxy advisors as the SEC's proposal. And we note that at the SEC's Proxy Roundtable, the SEC heard evidence that many asset manager clients of proxy advisors would prefer to see drafts before the company managers see the drafts.[32]

But this alternative would at least increase transparency in the process of proxy advice formulation, and reduce the risk that the proposal would bias proxy advisors towards managers, as the current rule proposal would do. It would avoid even the week of "silencing" of proxy advisors, as the current proposal would mandate, as they would be permitted to speak to their clients, and simply would require them to disclose drafts to companies. It would be content neutral, as (in theory) investment clients or other investors could see the drafts and attempt to persuade the proxy advisors to make the recommendations or reports more critical of corporate managers, even as corporate managers were attempting to persuade the proxy advisors to do the opposite, presumably in each case only if justified by facts or analysis.

6. Address risk that costs will fall disproportionately on small and medium size asset managers

We are concerned about the impact of the proxy advisor proposal on small and medium-sized asset managers. As the SEC notes, the market for proxy advice is highly concentrated. As a result, it is possible they will be able to pass through some or all increased compliance costs to their clients. Larger asset managers have increasingly internalized voting analysis, are less in need of advisory services, and have more effective choice to cut reliance if not cost-justified. Already, the SEC notes, "large institutions [rely] less than small institutions on the research and recommendations offered by proxy voting advice businesses."[33] Small and medium funds do not have this choice. They will face heightened compliance costs, which may render their businesses unsustainable. Independent small and mid-sized asset managers are under severe pressures from substantial consolidation in the asset management industry and ongoing shifts towards index-fund sponsors. In this context, the proposal should discuss its distributional impact on investment managers.

7. Discuss the risk that the proxy advisor proposal will decrease competition and degrade votes

Currently, the proxy advisor rule release acknowledges in passing on page 111 that "the proposed amendments would impose certain additional costs on proxy voting advice businesses," and that these costs "may not be offset by a reduction in compliance costs for their clients."[34] As a result, the release notes, tautologically, "If costs borne by proxy voting advice businesses are large enough to cause some businesses to exit the market or potential entrants to stay out of the market, the proposed rules could decrease competition." Finally, the SEC asserts that it cannot quantify the costs the proposal will create.

Together, these facts should lead to conclusions that the SEC does not state: the proxy advisor proposal creates the likelihood that smaller firms that the SEC seems to characterize as proxy advisors will exit the business (to the extent such firms are covered by the proposal), and potential new entrants will decide against doing business as proxy advisors; and there is a risk that one or both of the major proxy advisors may be unable to sustain its business model with the increased net costs caused by the rule. Given how dominant their market shares currently are, if one of the two leading advisors were to exit the market (and no new

entrant is willing to compete), the remaining leading advisor would have something close to a **monopoly**. A monopoly is not merely "decrease[d] competition," it is the very absence of competition.

The SEC Commissioners who voted for the proposal should reconsider carefully whether they want to bear that risk. Corporate managers backing the proposal, and their trade group representatives, should carefully reconsider what they are asking for – because they may get it, and not like the result. A resulting monopolist would have more influence in close corporate votes, be less likely to respond to the need for improvements, and have more price-setting power than presently. Investors would clearly lose from this outcome.[35]

The rule release should do more than it currently does to note these risks. It should draw on, and discuss more extensively than it currently does, information about the profitability, economies of scale, and resulting tendency towards monopoly in proxy advisory services.[36] It should note the pre-history of proxy advisory firms – the way that voting took place before proxy advisors emerged in the 1980s and 1990s – a world of voting that was not fairly characterized by high engagement, high levels of information, or carefully nuanced, firm-by-firm voting choices. It should more carefully discuss how increased compliance costs are typically fixed costs, invariant to scale, and will reinforce economies of scale that the current leading proxy advisors already enjoy. It should account for resulting social costs if the rule proposal creates a monopoly, and even if these costs cannot be precisely quantified, consider them in its cost-benefit analysis.

8. Concerns about conflict of interest disclosure requirements

While we agree that conflict of interest disclosure requirements could be improved for proxy advisors, we have concerns about the proposed disclosure requirements insofar as they require widespread disclosure of policies and procedures to address conflicts. We say "widespread" because as the SEC acknowledges, proxy advisors serve "thousands of clients."[37] We note the SEC purports not to be adopting a requirement that such policies and procedures be "published," but the practical reality of disclosure to thousands of clients will be quite similar to publication in important respects.[§]

As the SEC notes, there are good reasons for the proxy advisors to not publicize the details of their conflict of interest policies and procedures. For example, their staff may be better prevented from engaging in conflicted behavior if the policies and procedures were not widely available. The SEC makes this point to explain why it is not requiring publication of the policies and procedures. But the same would apply to widespread disclosure to "thousands of clients."

Consistent with the idea that widespread disclosure of compliance policies would impair their effectiveness, the SEC does not require widespread disclosure to customers or clients of compliance policies in other areas. The details – as opposed to the existence – of policies and procedures adopted by public companies to govern margin loans to executive officers (which routinely generates conflicts of interests) are not currently required to be provided to shareholders, nor are those that govern basic self-dealing by corporate executives. Investment advisers, broker-dealers and credit ratings agencies adopt policies and procedures to govern conflicts of interest for their professionals, and our understanding is that the details of such policies and procedures are not generally required to be disclosed on a widespread basis to investors, clients, or customers.

[§] One member of the IAC believes that the SEC should require disclosure (but not publication) of conflict of interest policies and procedures by proxy advisors, while the majority for those voting for this recommendation do not.

9. Concerns specific to the proposal regarding shareholder proposals

We also have a number of concerns about the proposal regarding shareholder proposals. At the outset we noted the absence of a fair statement of the value of shareholder proposals, which should be added to a revised and republished rule proposal.** We have several additional recommendations.

a. Analyze trends in votes, and avoid unjustified reliance on trends in exclusion rates

We recommend that the rule proposal adequately address trends in data on shareholder proposals over time. The economic analysis supporting the SEC's rule proposal implicitly assumes that the value of shareholder proposals overall is static – unchanged over time. It also assumes that because there have been fewer proposals that have been excluded due to the current thresholds over time, the value of shareholder proposals that go to a vote must be declining.

However, data on pages 70-90 of the release show that shareholder proposals have been gaining **higher votes over time**, which coupled with a **decline in the number of proposals voted**,[38] is consistent with an **increase in the value of proposals** over time.[39] These trends indicate that over time shareholders have sponsored more valuable and targeted proposals. These facts are noted in the SEC economic analysis. But they are not mentioned much less discussed adequately in the SEC's overall assessment that there is a need to curtail shareholder proposals, as its rule proposal is intended to do.

Instead of emphasizing the trends towards fewer, more valuable proposals, the SEC instead emphasizes the tangential fact that fewer proposals are being excluded by the initial submission requirements or the resubmission requirements. The SEC emphasizes the effect of inflation on the initial submission requirements, asserting that lower real thresholds leads to "overuse."[40] But it does not consider in its discussion of the "need for the proposed amendments" that proposals are obtaining higher average votes, which is inconsistent with a belief that inflation is eroding the value of the proposals. It also does not there consider the fact fewer proposals are being brought, which is inconsistent with a belief that inflation is resulting in too many proposals. These trends are inconsistent with "overuse."

With respect to resubmission requirements, the SEC seems to believe – without explanation -- that there should be some natural rate of exclusion due to resubmission requirements, and since there are fewer being excluded, the resubmission thresholds need increasing.[41] Yet benign and plausible reasons exist to expect resubmission requirements to have less of an impact in the face of a trend towards more valuable and targeted proposals. Given that trend, and given the ability of shareholder proposal proponents to learn with experience, it should not be surprising or troubling that fewer proposals are being excluded due to resubmission thresholds. The decline in excluded proposals is more likely to be due to an increase in overall support plus a readier recognition by proponents that a given proposal needs to be withdrawn, modified or improved than it is to a decline in the effectiveness of the current exclusion thresholds. The trend data show that the shareholder proposal screens are working effectively now, not that they need tightening.

b. More completely analyze the kinds of proposals that would be excluded and unjustified focus on majority-approved proposals rather than on proposals that receive support to be implemented or for which evidence shows they are value-enhancing

The SEC rule proposal inconsistently analyzes the **kinds of** shareholder proposals that would be excluded if the SEC proposal were to be adopted, and fails to consider available evidence about their value to investors of specific types of proposals that would be excluded by the rule proposals. The SEC release notes in its

** Several IAC members believe that the thresholds for submission and inclusion of shareholder proposals should be revisited by the SEC, while not endorsing the specific thresholds in the current rule proposal, believing that a more incremental approach would be more easily justified.

economic analysis that many proposals that would fail to meet the proposed resubmission thresholds nevertheless have received increasing and often large support over time, but the SEC does not discuss or confront that fact in its basic explanation for the need for the proposed changes. It also fails to discuss whether the proposals likely to be excluded are a type to which the market has reacted favorably when announced. The SEC acknowledges the shortcoming of its analysis: "Our economic analysis does not speak to whether any particular shareholder proposal or type of proposals are value enhancing, whether the proposed amendments would exclude value enhancing proposals, or whether the proposed amendments would have a disproportionate effect on proposals that are more or less value enhancing."[42]

The SEC should do more to analyze the types of proposals that would be excluded, and their likely value. For example, as noted by Commissioner Jackson in his dissenting statement:

> Proxy-access proposals -- initiatives to allow significant shareholders to put their own candidates up for election to the board … -- are popular proposals [that] hold underperforming executives' feet to the fire with a more realistic threat of a contested election. The evidence shows that these proposals often add value for shareholders over the long run. But today's rule would **remove 40% of these proposals** from the ballot after three tries—and keep them off for three years.

Commissioner Jackson's dissent draws on and cites to his staff's own analysis, as well as to published academic research. The SEC release does not cite or reflect any alternative analysis that supports the proposal on other grounds.

c. Adequately discuss plausible unintended consequences

While the SEC says that it is "mindful of concerns that any revisions to the ownership requirements may have a greater effect on shareholders with smaller investments,"[43] we believe it should adequately consider the data on household wealth, the need for diversification, and the resulting implications for how many individual shareholders would be practically able to sponsor proposals under the proposed rule. It particularly neglects to discuss sufficiently the impact of the proposed changes regarding use of representatives on small and medium-sized shareholders, the very "Main Street" investors of the kind so emphasized by Chair Jay Clayton in his time as Chair. As Commissioner Lee rightly emphasizes in her dissenting statement, the results of the rule proposal would be that:

> Main Street investors would generally have to invest virtually their **entire portfolio into one company** (something we strongly discourage) to enjoy the same rights as Wall Street investors, or they would have to wait three years to catch up to them.

The proposed changes regarding initial threshold requirements obviously raise the effective cost for small and medium-sized shareholders to bring proposals, and the proposed changes on the use of representatives will do so indirectly. Meanwhile, the higher initial thresholds will be trivial for large shareholders, and they will be able to bring proposals without relying on representatives. Yet as the SEC notes, proposals sponsored by individuals (who typically own less stock) are often able to obtain high shareholder support, at levels that are comparable to or higher than for resolutions sponsored by institutions. Indeed, "**The percentage of proposals submitted by individuals that received majority support is statistically significantly higher than the percentage of proposals submitted by institutions that received majority support**."[44]

For the SEC to simply assert that it is mindful of the effects on small shareholders, and that it believes that the rules will "adequately permit"[45] all shareholders to do so, is not supported by the relevant facts.

Additional unintended consequences of the SEC proposal on shareholder proposals are plausibly to limit and interfere with the variety of complex relationships that exist among shareholders and their agents. For

example, the proposed "one proposal per person" rule may limit the ability of institutional investors to select the agent of their own choosing to represent them for shareholder engagement purposes.

d. Adequately explain and justify the momentum requirement of 10%

We believe the release should analyze and justify the proposed ability of issuers to exclude resubmitted proposals if the support they receive declines by 10% or more compared to the immediately preceding shareholder vote on the matter. We note initially that the release and proposal could be clarified as to how the requirement would work – on one reading, it would permit exclusion only if a proposal obtained an absolutely lower 10% vote – e.g., from 20% to 10% -- while in other places the release seems to state that the proposal would permit exclusion if a proposal obtain a relatively lower 10% vote – e.g., from 20% to 17.9% (which is more than 10% x 20% = 2% less than 20%). We note particularly if the intent is a relative 10% decline as a trigger, more analysis is needed to justify it. Even if a proposal is obtaining an overall increasing level of vote support over time, year-to-year votes can reasonably be expected to fluctuate due to random factors beyond the control of the sponsor, and that have little to do with the merits or support for the proposal. Given that, without more analysis, it is unclear how the SEC arrived at the 10% decline trigger, or how it would apply to the range of proposals companies regularly receive. This is also troubling because standard statistical techniques – known to the SEC's staff -- would take into account such fluctuations in providing information about how often a proposal receiving increasing support is likely to ever be implemented or receive high absolute levels of support. Failing to present such analysis if inconsistent with the SEC's guidance on economic analysis, and leaves the public uncertain as to the likely and predictable effects of the requirement.

e. Adequately present and analyze reasonable alternatives

Finally, as with the proxy advisor proposal, the SEC's release should consider reasonable alternatives that would be more likely to improve social welfare than the actual proposal. For example, the SEC could raise current resubmission thresholds by 1%, rather than jumping from 3% to 6%, etc. Having raised them 1%, the SEC could observe shareholder and company behavior and develop a much more accurate understanding of the relationship between the higher thresholds, the number of proposals that are brought, and voting outcomes. If a significant number of proposals continue to be resubmitted and then fail to get more than 4%, etc. then the SEC could also raise the thresholds by another 1%. And so on. This incremental approach would avoid the risk of "overshooting" and shutting down a whole cohort of proposals that otherwise would obtain higher votes over time.

10. Reconsider the guidance

In addition to republishing the rule proposals, the SEC should reconsider the guidance actions it took in the summer of 2019. Our review of the guidance, public statements by the SEC Commissioners in adopting the guidance, conversations with SEC staff, and our conversations with investors and investment advisors all suggest that the guidance did not achieve what it sought to achieve, i.e., clarity for market participants. On the one hand, the SEC purported to not be changing anything material in its rules regarding shareholder voting or reliance on proxy advisors. On the other hand, there are widespread impressions, reinforced by some statements in and about the guidance by SEC Commissioners and staff, that the guidance was intended to "update" the way the SEC approached investment advisors' fiduciary duties relating to proxy voting. From the perspective of a regulated investment advisor, any alteration that may increase the scrutiny of the SEC in its evaluation of compliance with a fiduciary duty is material. The resulting confusion is therefore highly problematic and, for the reasons we describe in more detail in the next paragraph, we therefore recommend that the SEC reconsider its interpretations.

There is an inconsistency between "no change" and "update." As a result of that and other ambiguities in the guidance documents, investors have widely varying beliefs about the import of the guidance actions, ranging

from "no change" to "significant increase in likely costs of compliance." We also note that a pending lawsuit suggests that a highly informed (but also highly interested) participant in the proxy system (ISS) does not view the guidance actions as reflecting "no change," and while we take no position on the merits of its lawsuit, it does corroborate some of the confusion that we believe the guidance actions created. The lack of clarity may reflect the fact that the guidance did not go through a public notice-and-comment process, in which asset managers could have been asked whether the proposed guidance documents actually did add clarity. While we believe that interpretation and guidance are important ways the SEC can implement its views, and that many issues are properly addressed without formal rulemaking, we believe the SEC should be open to revisiting efforts to interpret and provide guidance when they have not provided the clarity that they are intended to provide.

More generally, the guidance actions are related to the content of the two rule proposals, and the SEC has an opportunity to provide both clear and improved guidance as it reconsiders the rule proposals. The SEC should consider that the guidance documents do not appear to have in face provided clarity or actual guidance and were approved without the kinds of input by knowledgeable stakeholders that are now being provided to the SEC as part of the current rulemaking process, and should reconsider the guidance documents in the context of revised rule proposals that respond to the above recommendations.

Annex A

As discussed in the recommendation, the SEC's rule releases fail to fairly present the benefits of proxy advisors and shareholder proposals in the rule releases, while going on at great length at what problems those elements of the proxy system "may" create. This annex provides the starting point for a more complete description of some of the benefits of those elements.

a. Value of proxy advisors

Proxy advisors provide a very useful service to shareholders, increasing overall welfare by enhancing corporate governance. They distill hundreds of pages of information in proxy statements down to a much smaller number of pages in a consistent format that is easy for clients to digest. These clients have to vote hundreds or even thousands of proxies per year. Most proxy votes must be analyzed and voted during a two-month period of time (May to June), making it virtually impossible for those with voting authority to engage in a de novo review of the entirety of the information provided to them by companies, dissidents and others commenting on the votes. In short, proxy advisors are necessary for a large number of shares to be voted on an informed and timely basis.

For investment fiduciaries, these proxy advisor services are highly valuable, and permit them to carry out their obligations of stewardship in a responsible and cost-effective manner. While some have raised concerns that proxy advisory firm clients vote reflexively or automatically as if the proxy advisory recommendations were binding, there is little reliable evidence that this is a widespread problem. It is entirely appropriate for proxy advisory firm clients to take into account the independent views and information provided by proxy advisors. And because many votes are essentially uncontested (the vast majority of director elections, for example), it is not surprising that there is a high correlation between proxy advisory recommendations and votes of asset managers – indeed, it would be odd and disconcerting if clients routinely voted against the recommendations of advisory firms whose primary business focus are those votes. This is not the same thing as automatic or reflexive voting, however. It simply reflects use of objective and quantitative information provided by advisors in a context in which many shareholders share the same goals and beliefs.

A final point should be made about the value of proxy advisors: they are independent. Despite the claims of pervasive conflicts of interest, it should be obvious that they are less conflicted than others with an interest in the outcome of the votes themselves. The very jobs of the boards of directors of the companies who are holding shareholder votes are at stake in their elections, by definition. Other matters on which shareholders vote commonly constrain director discretion. Dissidents and short-slate sponsors are seeking power and influence for themselves. Proxy advisors do not seek or obtain board representation, they do not obtain the ability to pay themselves compensation from the companies involved, as directors and dissidents do, and they do not directly benefit from the result of any change in the discretion of directors of a company.

Proxy advisors thus play an important and irreplaceable role as independent voices in the proxy system. They can be expected to look for and find flaws or bias in the peer group selections made by officers of companies – who make those selections precisely to benchmark their own pay. Without proxy advisors, shareholders would be left in a typical vote with one and precisely one voice to listen to – those of directly self-interested directors and officers. Alternatively, in the context of proxy fights or struggles between boards and activists such as hedge funds, proxy advisors provide a neutral point of analysis with an interest in preserving the status quo for the board nor any direct financial interest in helping the dissidents obtain board seats. Proxy advisors balance the interests of shareholders of all types in voting their shares in all companies in which they hold shares, and do so by looking at issues and votes solely through the eyes of investors.

b. Value of shareholder proposals

Shareholder proposals provide a number of important social benefits. Despite the vast majority being legally non-binding, they commonly are implemented by managers, despite initial opposition or resistance by boards, suggesting that they can persuade managers to review and revise their beliefs about topics covered by resolutions. In particular, they can address potential agency costs – reduction in value caused by managerial entrenchment – and a broad stream of academic research shows that shareholder proposals have demonstrably done so over the past twenty years. Indeed, a peer-reviewed article on shareholder proposals in the leading finance journal concludes: "Shareholder activism and improved democracy inside firms can have **large positive effects on shareholder value**."[46]

Even when shareholder proposals do not result in a majority-approved vote, they facilitate "closer scrutiny of important substantive issues" such as takeover defenses and executive compensation." In contrast to the relatively low-information environment of the 1990s as regards takeover defenses and executive compensation, for example, shareholder proposals have increasingly led institutional investors – informed by proxy advisors – to become much more sophisticated and focused in their analysis of these topics. The routinized discipline of companies and shareholders being required to engage in debates over shareholder proposals reduces uncertainty and information asymmetries, increasing market efficiency.

As an example, in the 1990s, it was common for shareholder proposals to focus on "poison pills," despite the fact that the redemption of a pill could be reversed quickly without a shareholder vote, and generally could be undercut by a determined bidder capable of launching a proxy contest – in effect, shareholder proposals led to a non-solution to a non-problem. Over time, however, the debate over takeover defenses became more serious, in large part due to shareholder proposals, and the focus in the 2000s of most defense-specific proposals shifted to classified boards, which cannot be added by boards without a shareholder vote, and which do have meaningful effects on takeover outcomes. "As a result of shareholder proposals, a substantial number of companies dismantled their takeover defenses."[47]

The effect over time has been similar with respect to executive compensation. Initial focus on simply increasing incentive compensation in the late 1980s and 1990s shifted – due to shareholder proposals and subsequently "say on pay" votes – to much more detailed and informed analysis of total pay packages, long-term compensation, hold-backs, and other important elements of how executives are paid and incentivized. Without shareholder proposals, or with fewer of them, the public debate and firm-specific analysis of pay would have either not occurred, or taken longer to occur. Moreover, votes on shareholder proposals on pay have effects not simply because they achieve majority votes, but when they simply achieve higher votes than expected. "Boards reduce the rate of executive pay increases if a proposal targeting CEO compensation receives unexpectedly high shareholder support."[48] In sum, "Rule 14a-8 is serving a more valuable function today than in the past because it may be more greatly reducing agency costs of the separation of ownership and control than has previously been reported."[49]

Shareholder proposals can also matter because they can lead to situations where shareholders learn about how shareholder-oriented managers in fact are, without the need for an expensive and rate proxy fight. Thus, "the impact of shareholder proposals is not restricted to their actual content."[50] This "signaling" effect is significant enough to generate stock market reactions that are measurable and material. In addition, shareholder proposals are an important vehicle for communication of views among shareholders – not just from the proponent, but also between non-proponent shareholders who can see what issues, in the collective view of shareholders, may have particular merit. In a market where communication between shareholders is sharply constrained, in large part by SEC rules, the value of an unambiguous signal from a vote on a specific proposal (as opposed to, for example, registering concern by withholding support from a director) has an important value not currently considered in the SEC's rule proposal or the accompanying economic analysis.

[1] Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-87457; File No. S7-22-19 (Nov. 5, 2019); Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Release No. 34-87458; File No. S7-23-19 (Nov. 5, 2019); Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5325 (Aug. 21, 2019) [84 FR 47420 (Sept. 10, 2019)]; Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019) [84 FR 47416 (Sept. 10, 2019)].

[2] Rel. No. 34-87457 at 27-38.

[3] See, e.g., the SEC public overview entitled Securities Analyst Recommendations, available at https://www.sec.gov/fast-answers/answersanalysthtm.html ("Analysts are generally required to disclose possible conflicts of interest when they recommend the purchase or sale of a specific security."); SEC Analyzing Analyst Recommendations (Aug. 30, 2010), available at https://www.sec.gov/tm/reportspubs/investor-publications/investorpubsanalystshtm.html (nine paragraphs discussing "potential conflicts of interest").

[4] Rel. No. 34-87457 at 26.

[5] Rel. No. 34-87457 at 80.

[6] Rel. No. 34-87458 at 112.

[7] Roundtable on the Proxy Process (Nov. 25, 2018), at 257.

[8] Current Guidance on Economic Analysis in SEC Rulemakings, Memo dated March 6, 2012, available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf at 14.

[9] Id.

[10] Current Guidance, supra note 7, at 1 et seq. (referring repeatedly to analysis about "proposed" rulemaking).

[11] Neither proxy advisors nor voting appear in OCIE's list of 2019 Exam Priorities, https://www.sec.gov/files/OCIE%202019%20Priorities.pdf, nor has OCIE issued a "risk alert" in the area of proxy voting, https://www.sec.gov/ocie (Risk Alerts tab). although it has issued a number of such alerts that reflect concerns it has about overall compliance with other aspects of law and regulation applicable to investment advisers. Enforcement has brought relatively few actions against investment advisers under Rule 206(4)-6 in the last twenty years. Indeed, we find **two** such actions, Rel. No. IA-2872; Rel. No. IA-3458, out of thousands of enforcement actions. SEC Division of Enforcement 2019 Annual Report (Nov. 2019), available at https://www.sec.gov/files/enforcement-annual-report-2019.pdf (indicating more than 4,000 enforcement actions in the last 5 years alone). If the SEC believes that conflicts of interest and errors by proxy advisors are creating significant problems in the proxy system, then one would expect it to have evidence that the very clients of those proxy advisors are not fulfilling their duties when they rely on proxy advisors, even in part. Yet the SEC's own experience to date is contrary to such an expectation.

[12] The SEC's proposed mandatory waiting periods consist of a three business day initial period followed by a two business day follow-up period. In practice, given that there are only five business days in any week, the actual waiting period will range from a minimum of seven to a maximum of nine calendar days.

[13] Rel. No. 34-87457 at 39.

[14] Rel. No. 34-87457 at n. 94. The SEC rule release cites a letter dated June 26, 2019; no such letter exists on the SEC's comments' website for its Proxy Roundtable (Roundtable on the U.S. Proxy Process File No. 4-725). The actual Exxon comment letter at that website is dated July 26, 2019. One could call this a "factual error" in the SEC rule release, and perhaps count it towards a total number of errors afflicting the SEC process in the proxy area. It is clearly not material, however, and so in fairness should not be so counted. The same judgment would be needed to be brought to bear on any errors in proxy advisor reports if in fairness one believed that such reports were filled with factual errors. Once one used that kind of judgment to exclude immaterial errors, it may be that no significant number of factual errors would remain. Perhaps that is why neither the Exxon letter nor the SEC assert that material factual errors are in fact a problem with proxy advisor reports.

[15] The SEC also cites in Rel. No. 34-87457 at n. 94 comments from the Business Roundtable, which provides no verifiable information about errors, but instead cites to anonymous reports it says it has received by surveying its members. Needless to say, anonymous unverifiable reports are an inadequate basis for concluding that material factual errors are common. The SEC also cites the Squire Patton Boggs LLC analysis discussed in note 15 below, as well a news article, Richard Levick, 'Vinny' and the Proxy Advisors: A Five Trillion Dollar Debate, FORBES.COM (Dec. 17, 2018), https://www.forbes.com/sites/richardlevick/2018/12/17/vinny-and-the-proxy-advisors-a-five-trillion-dollar-debate/#73164b9f2f4b, but that news article provides no independent support for claim that material factual errors are common, but instead relies on the Squire Patton Boggs LLC discussed in note 15 below. As noted in the text to that note, if anything, that analysis shows that "factual errors" requirement judgment to identify, the SEC's own analysis differs from that of Squire Patton Boggs LLC, and both analyses demonstrate that material "factual errors" are rare.

[16] Rel. No. 34-87457 at 96 (Table 2). That table is based on supplemental proxy statements filed by issuers over the period 2016-2018, and shows 54 factual errors out of a total of 17926 proxy statements. The release does not provide

information sufficient to evaluate materiality or the classification of errors as actually factual. Similar data published by Squire Patton Boggs LLC on behalf of the American Council for Capital Formation (a trade group representing the interests of corporate managers) that does provide data linking to actual supplemental proxy statements shows that in a number of instances, what were purportedly "factual errors" in fact were disagreements of opinion. Analysis available at https://accfcorpgov.org/wp-content/uploads/Analysis-of-Proxy-Advisor-Factual-and-Analytical-Errors_October-2018.pdf For example, with respect to the proxy supplement filed by Abbot Laboratories on April 5, 2018, the dispute fact is described in the summary in part as "ISS selected the wrong peer group," id., which is the lead "error" identified in the proxy supplement itself, https://www.sec.gov/Archives/edgar/data/1800/000110465918022657/a18-9600_1defa14a.htm at 1. While Abbott's supplement states a number of other "errors" in methodological choices made by ISS, none are clearly "factual" in nature. As another example, Ambarella, Inc..'s supplemental proxy statement filed May 30, 2018 is cited by Squire Patton Boggs LLC as showing a "factual error" because ISS stated that the company's CEO had received a larger equity award, when the company claimed the award was actually smaller. See https://www.sec.gov/Archives/edgar/data/1280263/000119312518177136/d789640ddefa14a.htm at 5. However, the company concedes that its own compensation table showed an increase in the award, and argued that the increase was due to a change in timing of grants, increasing the period between grants to 18 months, a point that may be analytically correct but which does not render the ISS statement factually incorrect, and the supplemental proxy provides no basis for assuming that the analytical disagreement was material. Nonetheless, the Squire Patton Boggs LLC report identifies the disagreement as a "factual error." Finally, we note that there are significant discrepancies between the number of "factual errors" identified by the SEC based on its review of the supplemental proxy statements in the same time period as the number of "factual errors" identified by Squire Patton Boggs LLC in the same time period (compare 13 "factual errors" for the year 2017 in Table 2 of Rel. No. 34-87457 at 96 with 23 "factual errors" for the same year in the Squire Sanders Boggs LLC summary table).

[17] Even though it could have done so easily, the SEC did not provide any links or other way to verify even this minimal number of alleged factual errors, rendering the data worthless for public evaluation of the rule proposal.

[18] See, e.g., Summary Report of Commission Staff's Examinations of Each National Statistical Rating Organization (Dec. 2018), available at https://www.sec.gov/files/nrsro-summary-report-2018_0.pdf (discussing numerous 2018 errors reported a credit rating agency).

[19] See, e.g., Jeremiah Green, John R. M. Hand, X. Frank Zhang, Errors and questionable judgments in analysts' DCF models, Rev Account Stud (2016) 21:596–632, at Table 5 (reporting average error rate of 33% in discounted cash flows models in sample of 120 securities analyst reports, consisting of, for example, internal inconsistencies between analyst's own inputs to the analyst's own capital asset pricing model and the analyst's own resulting equity discount rate of more than 30 basis points), as well as Table 6 (reporting separately an average rate of questionable judgments of 21%).

[20] By contrast, **2.5%** of **medical post-mortems** find diagnostic errors related to the principal diagnosis or cause of human death. National Academies of Sciences, Engineering and Medicine, IMPROVING DIAGNOSIS IN HEALTH CARE, Committee on Diagnostic Error in Health Care, eds. Erin P. Balogh, Bryan T. Miller, and John R. Ball, Editors, Board on Health Care Services, Institute of Medicine, available at https://www.nap.edu/read/21794/chapter/5#101. In other words, in life and death situations, doctors are more than eight times more frequently wrong than the proxy advisors have been shown to be in making recommendations (and in fact, even more frequently, because the medical error rate is after screening for the materiality of the error, while the claimed proxy advisory factual error rate is not). Medical diagnoses are obviously a different factual setting from proxy advisory reports in many respects. But the higher life-and-death personal stakes for both patients and doctors should make the error rate in that setting lower than in less fraught situations, such as in non-binding, advisory reports about shareholder votes the outcome of which rarely are determined by the reports.

[21] It is insufficient to claim, as do some commentators, that the supplemental proxies filed by corporate managers establish a lower bound on the number of errors in proxy reports. There is nothing to suggest that proxy advisors ever retaliate against companies for correcting factual errors, and if potentially material to vote outcomes, corporate managers have ample incentives to seek corrections, and they can use investor funds to do so.

[22] Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. ___ (2015) ("A fact is 'a thing done or existing' or '[a]n actual happening.' Webster's New International Dictionary 782 (1927). An opinion is 'a belief[,] a view,' or a 'sentiment which the mind forms of persons or things.' Id., at 1509. … That [sic] difference between the two is so ingrained in our everyday ways of speaking and thinking as to make resort to old dictionaries seem a mite silly."); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 669, 674 (6th Cir. 2005) (court distinguished between hard information and soft information, and said about the latter that "vague statements not subject to verification by proof are generally deemed non-actionable"); Rosenzweig v. Azurix Corp., 332 F.3d 854, 869-70 (5th Cir. 2003) (statements that company's "fundamentals are strong," that it is "making steady progress" and that its "pipeline of private transactions . . . remains strong," are immaterial [and] not actionable under the securities laws); In re Lululemon Sec. Litig., 14 F.Supp.3d 553, 2014 WL 1569500, at *15-16 (S.D.N.Y. Apr. 18, 2014) (holding statements were not

materially false or misleading because they were statements of opinion or belief and the complaint did not allege that defendants did not believe them at the time they were made); Rubke v. Capital Bancorp Ltd., 551 F.3d 1156 (9th Cir. 2009) ("[M]isleading opinions . . . can give rise to a claim under section 11 only if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading."); In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 368 (3d Cir. 1993) (explaining that opinions, predictions, and other "statements of 'soft information' may be actionable misrepresentations if the speaker does not genuinely and reasonably believe them").

[23] Comment of Brian Stoner, dated November 21, 2019, available at https://www.sec.gov/comments/s7-22-19/s72219-6458605-199162.htm, citing a Conference Board report available at (https://law.rutgers.edu/sites/law/files/RR-1674-18-R.pdf.

[24] Rel. No. 34-87457 at 97, citing GAO Report to Congress, *Corporate Shareholder Meetings—Proxy Advisory Firms' Role in Voting and Corporate Governance Practices* (Nov. 2016) at 23.

[25] Roundtable on the Proxy Process (Nov. 25, 2018), at 214.

[26] Id. at 256.

[27] Id. at 251.

[28] Id. at 247-48.

[29] Id. at 238.

[30] Id. at 250. No panelist on the proxy advisor panel thereafter spoke in favor in regulating proxy advisors. These statements and the absence of a response to the staff member's question are not even noted in the rule release, even as the shareholder proposal rule release relies heavily on proxy roundtable testimony.

[31] Rel. No. 34-87457 at 113 et seq.

[32] Roundtable on the Proxy Process (Nov. 25, 2018), at 232. This statement was made by a representative of ISS, one of the two leading proxy advisors. The SEC might usefully test the truth of this statement by affirmatively surveying clients of the proxy advisors. But it should be noted that on the same panel as the ISS representative were representatives of investment advisers and asset owners, and no one spoke up to suggest that the assertion was incorrect.

[33] Rel. No. 34-87457 at 80.

[34] Rel. No. 34-87457 at 111.

[35] Worse, there is also a serious possibility that **neither** of the leading proxy advisors may have a sustainable business model if the rule proposal is adopted. A predictable result would be **more one-size-fits-all voting** by a larger number of investment managers, not **less**, as the rule release implies.

[36] See, e.g., Paul Joskow, Regulation of Natural Monopoly, in Handbook of Law and Economics.

[37] Rel. No. 34-87457 at 10.

[38] Rel. No. 34-87458 at 74.

[39] The release initially states that "Our analysis shows no discernible trend in the number of submitted shareholder proposals in the 1997 to 2018 period," id. at 70, but also says that "Data on submitted proposals prior to 2004 is incomplete. Hence, our economic analysis focuses on shareholder proposals submitted between 2004 and 2018." Later, the release notes that the aggregate increase in shareholder support has been accompanied by a **significant decline in the total number of proposals** over the past fifteen years, from 1.85 per company in 2004 to 1.24 in 2018 at S&P 500 companies, and from 0.38 in 2004 to 0.28 in 2018 and Russell 3000 companies.

[40] Id. at 18.

[41] Id. at 49-50; see also at 52 (equating without explanation or discussion "meaningful" and "majority" support); n. 122 (giving data on how often proposals initially receiving low votes go on to obtain majority support).

[42] Id. at 112.

[43] Rel. No. 34-87458 at 25.

[44] Id. at 89.

[45] Id. at 44 ("climate-change proposals … averaged voting support of [~5%] in 1999 and [~38%] by 2017).

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