



February 3, 2020

Ms. Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-0609

Re: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice  
Release No. 34-87457  
SEC File No. S7-22-19

Dear Ms. Countryman:

Thank you for the opportunity to comment on the “Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice,” recently proposed by the Securities and Exchange Commission.<sup>1</sup> Glass Lewis shares the Commission’s goal of making sure that the proxy process functions properly and enables shareholders to exercise their right to vote at annual and special meetings. To that end, Glass Lewis has engaged with the Commission on numerous occasions during its continuing efforts to explore how to improve the proxy process, a critical component of the corporate governance system.

Glass Lewis also fully supports and embraces the stated objectives of the Commission’s proposal with respect to proxy advice — promoting the accuracy, conflict management and disclosure, and transparency of that advice. This includes appropriate engagement with the companies that are the subject of proxy advice. In fact, we have committed to follow the internationally-endorsed Best Practices Principles for Shareholder Voting Research Providers, which address these critical issues, and annually report on our compliance with those principles.

Regrettably, however, we believe that the proposed rules would not further those objectives, but instead would have severe adverse consequences for investors and the public interest. In particular, we are deeply concerned that the costly and rigid “review and feedback” mechanisms in the proposed rules would introduce significant and unmanageable delays into the already compressed annual meeting time frame and threaten to impair proxy advisors’

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<sup>1</sup> U.S. Securities and Exchange Commission, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-87457 (Nov. 5, 2019) (the “Proposing Release” or “Release”).



independence. Both effects could hamper Glass Lewis' ability to meet its institutional investor clients' needs, while at the same time detracting from the limited time available for investors' deliberations and ability to engage with companies on critical corporate governance issues. These adverse consequences would be compounded by the Commission's plan to codify its August 2019 Interpretation that proxy advice is a solicitation, which introduced the specter of companies filing lawsuits to challenge matters of judgment, including proxy advisors' methodologies, opinions and recommendations.

We are also concerned that the rushed process that has been followed in this rulemaking is not sufficient to adequately consider the legal issues its novel approach would raise and to fully understand and analyze the consequences — economic and otherwise — of the untested, unprecedented regulatory regime it would introduce. Accordingly, we respectfully submit that the Commission should not adopt the proposed rules and, instead, should continue to work with proxy advisors, investors and other stakeholders to develop a balanced and thoughtful approach to this area that better serves the interests of all market participants.

## **I. Background.**

### **A. Glass Lewis.**

Founded in 2003, Glass Lewis is a leading independent proxy advisor. As a proxy advisor, the Glass Lewis provides proxy research and vote management services to institutional investor clients throughout the world. While, for the most part, investor clients use Glass Lewis research to help them make proxy voting decisions, these institutions also use Glass Lewis research when engaging with companies before and after shareholder meetings. Further, through Glass Lewis' Web-based vote management system, Viewpoint®, Glass Lewis provides investor clients with the means to receive, reconcile and vote ballots according to custom voting guidelines and record-keep, audit, report and disclose their proxy votes.

Glass Lewis serves more than 1,300 institutional investor clients — primarily pension funds, mutual funds and other institutions that invest on behalf of individual investors and have a fiduciary duty to act, including through proxy voting, in the best interests of their beneficiaries. In 2018, Glass Lewis issued 23,210 proxy research reports, including 5,565 reports on U.S. issuers and 17,550 reports on non-U.S. issuers.<sup>2</sup>

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<sup>2</sup> This letter uses 2018 numbers for consistency with our earlier submission on the Release's Paperwork Reduction Act ("PRA") analysis. See Letter from Nichol Garzon-Mitchell, Senior Vice President and General Counsel, Glass Lewis to Alexander Goodenough, Office of Management and Budget (Jan. 7, 2020), available at <https://www.sec.gov/comments/s7-22-19/s72219->



In addition, a significant majority of Glass Lewis' clients have their own custom voting policies. Glass Lewis helps these clients implement their policies by applying them to the circumstances presented by companies in their proxy statements and recommending how they vote accordingly. During the policy formulation process, an institution will review Glass Lewis' policies to assess the similarities and differences between the institution's views and Glass Lewis' "house policy." Glass Lewis engages extensively with institutional investors and aims to have policies that reflect the views of its clients. Accordingly, it is not uncommon for an investor client to elect to implement the same policy as Glass Lewis for some or all of the issues up for vote. Institutional investors are increasingly opting for more detailed policies with specific views on how to address the issues that may come up on a proxy (e.g., U.S. companies alone have approximately 250 issues), and, as noted above, most therefore have custom voting policies. In many instances, their views are so specific to each unique situation that they will often opt for case-by-case analysis.

Glass Lewis also executes votes on behalf of investor clients in accordance with the specific instructions of those clients. To that end, Glass Lewis implements client voting policies on its vote management system so that each ballot populates with recommendations based on the specific policies of the client, enabling the client to submit votes in a timely and efficient manner. (Under no circumstance is Glass Lewis authorized to deviate from a client's instructions or to determine a vote that is not consistent with the policy specified by the client.) When a preliminary ballot is ready for review, the voting system will alert the client and provide such client with relevant disclosures and other information needed to review and evaluate the matters up for a vote. Clients can choose to restrict the submission of a ballot until after their authorized personnel have reviewed and approved the votes. Clients can also make — and often do make — changes to their preliminary ballots before signing off. And, assuming the voting deadline has not passed, they can even change their votes and resubmit them.

## **B. The role of proxy advisors.**

Glass Lewis believes that proxy advisors play an important support role, providing resources and technical, subject-matter expertise to help institutional investors meet their fiduciary responsibility to vote securities on behalf of their participants and beneficiaries in a cost-effective way. As the Commission itself has explained, "When making voting determinations on behalf of clients, many investment advisers retain proxy advisory firms to perform a variety of functions and services . . . . Contracting with proxy advisory firms to

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6617071-202957.pdf ("PRA Submission"). In 2019, Glass Lewis issued 26,198 reports, including 5,460 reports on U.S. issuers and 20,738 reports on non-U.S. issuers.



provide these types of functions and services can reduce burdens for investment advisers (and potentially reduce costs for their clients) as compared to conducting them in-house.”<sup>3</sup>

As an increasing share of American investors own stock indirectly, such as through mutual and pension funds, these individual investors are dependent on those institutional investors to vote on their behalf and act in their best interest. In order to do so both effectively and efficiently, those institutional investors often leverage their resources by using the services of a proxy advisor. As the Council of Institutional Investors and a coalition of investors have explained:

Retail holders now invest much of their capital with institutional investors because they understand that institutional investors’ expertise and size bear the expectation of higher returns, lower costs and mitigated risks. Importantly, retail investors also understand that aggregating their individual holdings into larger, concentrated blocks through an institutional manager allows for more effective monitoring of company management.

Even so, institutional investors themselves face challenges in spending significant time and resources on voting decisions because the funds and other vehicles they manage receive only a portion of the benefits conveyed on all investors of the relevant enterprise.

*Proxy advisors are a market-based solution to address many of these practical cost issues.* Proxy advisors effectively serve as collective research providers for large numbers of institutional investors, providing these investors an affordable alternative to the high costs of individually performing the requisite analysis for literally hundreds of thousands of ballot proposals at thousands of shareholder meetings each proxy season.<sup>4</sup>

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<sup>3</sup> U.S. Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5325 at 5 (Aug. 21, 2019) (“August 2019 Guidance”); see also comments of Chairman Jay Clayton at the U.S. Chamber of Commerce event on “Corporate Governance: Making the Case for Reform” (July 16, 2019) (“Outsourcing . . . in itself is not a bad thing. All the time in America we create value through outsourcing, outsourcing ministerial tasks, in this case, of going through filings and crunching the data, providing data reports, that’s good. It probably saves shareholders, saves investors money.”), available at <https://www.centerforcapitalmarkets.com/event/corporate-governance-making-the-case-for-reform/>.

<sup>4</sup> Letter of Ken Bertsch, Executive Director, Council of Institutional Investors and 60 institutional investors to Chairman Jay Clayton, at 2 (Oct. 15, 2020) (“CII October 15 Letter”); see also Michael Cappucci, Harvard Management Company, “The Proxy War Against Proxy Advisors,” at 7-8 (Nov. 16, 2019) (“Importantly, [proxy advisors] economize the proxy research and voting



Even the largest asset managers can benefit from the work of proxy advisors. As Professor S.P. Kothari, now the Commission's Chief Economist, has explained:

Although large asset managers typically have a unit responsible for recommending proxy votes, it's usually small and hard-pressed to review the more than 1,000 proxies it might be sent during proxy season. Staffers in such units readily admit they lack the time and expertise to conduct in-depth analyses of complex issues like non-GAAP criteria and peer group composition. That's why most asset managers subscribe to proxy advisory services, such as Institutional Shareholder Services (ISS) and Glass Lewis (GL).<sup>5</sup>

In addition, proxy advisors can help asset managers and other investors mitigate their own conflicts of interest in voting shares on behalf of their participants or beneficiaries. As the SEC has noted, an investment adviser "may look to the voting recommendations of a proxy advisory firm when the investment adviser has a conflict of interest, such as if, for example, the investment adviser's interests in an issuer or voting matter differ from those of some or all of its clients."<sup>6</sup> While the investment adviser, of course, remains responsible for voting in its clients' best interests, the SEC has also noted that "this third-party input into such an investment adviser's voting decision may mitigate the investment adviser's potential conflict of interest."<sup>7</sup>

### **C. The regulatory environment of proxy advisors.**

Proxy advisors are hired by and work to assist institutional investors in voting shares on behalf of their clients and beneficiaries. Existing SEC rules establish a robust regulatory

functions by spreading the costs of tracking, analyzing, and processing many thousands of proxy votes over a larger pool of shareholders."), available at <https://corpgov.law.harvard.edu/2019/11/27/the-proxy-war-against-proxy-advisors/>.

<sup>5</sup> Robert C. Pozen and S.P. Kothari, "Decoding CEO Pay," Harvard Business Review (July-Aug 2017); see also United States Department of Treasury report to President Trump on "A Financial System that Creates Economic Opportunities, Capital Markets," at 31 (Oct. 2017) ("institutional investors, who pay for proxy advice and are responsible for voting decisions, find the [proxy advisory firm] services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements").

<sup>6</sup> August 2019 Guidance at 5-6.

<sup>7</sup> Id. at 6.



framework for investment advisers' voting of proxies on behalf of their clients, including imposing specific responsibilities for their oversight of third-party service providers they use in the voting process.

First, advisers must comply with Rule 206(4)-6 under the Investment Advisers Act of 1940, which is specifically "designed to ensure that advisers vote proxies in the best interest of their clients."<sup>8</sup> Under this rule, investment advisers must: 1) adopt policies and procedures to ensure proxies are voted in the best interest of clients; 2) disclose to clients how they can obtain information from the adviser on how their securities were voted; and 3) describe the adviser's proxy voting policies and procedures to clients, and, upon request, provide clients with a copy of those policies and procedures. Investment advisers must also annually review the adequacy of their proxy voting policies.<sup>9</sup>

Second, investment companies must disclose how they vote proxies relating to portfolio securities they hold and file with the SEC and make available to shareholders information about specific proxy votes cast.<sup>10</sup> Public disclosure of votes creates market discipline, allowing current and potential investors to evaluate how mutual funds and others are voting their shares on issues of concern to them.<sup>11</sup>

The SEC has also specifically and repeatedly addressed investment advisers' regulatory responsibilities to oversee the work of any proxy advisors they hire to aid their proxy voting. First, the Staff issued guidance in 2014 with its expectations for adviser due diligence and oversight of proxy advisors.<sup>12</sup> Among other things, the Staff outlined a number of steps advisers can take before retaining a proxy advisory firm, including evaluating the proxy advisor's: 1) staffing and personnel; 2) ability to identify and address any conflicts of interest;

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<sup>8</sup> U.S. Securities and Exchange Commission, Proxy Voting by Investment Advisers, SEC Release No. IA-2106 (Jan. 31, 2003).

<sup>9</sup> Rule 206(4)-7 under the Advisers Act, 17 C.F.R. 275.206(4)-7.

<sup>10</sup> U.S. Securities and Exchange Commission, Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, SEC Release No. 33-8188 (Jan. 31, 2003).

<sup>11</sup> See, for example, Jeff Sommer, "Want a Bigger Say on Corporate Behavior? Move your Money," New York Times (Dec. 12, 2019).

<sup>12</sup> U.S. Securities and Exchange Commission, Staff Legal Bulletin No. 20, Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms (June 30, 2014).



and 3) policies and procedures to ensure that its voting recommendations are based on accurate information. The Staff conveyed that it expects advisers to engage in ongoing oversight of the proxy advisor on these issues.

Most recently, just this past August, the Commission issued a release with further guidance for investment advisers on their proxy voting responsibilities, including their use of proxy advisory firms to assist them in exercising these responsibilities. Building on the Staff's 2014 guidance, the Commission release outlines a number of steps an investment adviser can take to fulfill its regulatory responsibilities when it retains a proxy advisor. In addition to more specific, detailed questions relating to the proxy advisor's capacity and potential conflicts, the August 2019 Guidance suggests investment advisers consider:

- Whether the proxy advisory firm has an effective process for seeking timely input from issuers and proxy advisory firm clients with respect to its proxy voting policies, methodologies and peer group constructions;
- Whether a proxy advisory firm has adequately disclosed to the investment adviser its methodologies in formulating voting recommendations;
- The nature of any third-party information sources that the proxy advisory firm uses as a basis for its voting recommendations;
- When and how the proxy advisory firm would expect to engage with issuers and third parties;
- The effectiveness of the proxy advisory firm's policies and procedures for obtaining current and accurate information relevant to matters included in its research and on which it makes voting recommendations;
- The proxy advisory firm's engagement with issuers, including the firm's process for ensuring that it has complete and accurate information about the issuer and each particular matter, and the firm's process, if any, for investment advisers to access the issuer's views about the firm's voting recommendations in a timely and efficient manner;
- The proxy advisory firm's efforts to correct any identified material deficiencies in the proxy advisory firm's analysis;
- The proxy advisory firm's disclosure to the investment adviser regarding the sources of information and methodologies used in formulating voting recommendations or executing voting instructions; and





- The proxy advisory firm’s consideration of factors unique to a specific issuer or proposal when evaluating a matter subject to a shareholder vote.<sup>13</sup>

The August 2019 Guidance also explains that “an investment adviser is not required to accept the authority to vote client securities, regardless of whether the client undertakes to vote the proxies itself,” and, in fact, gives a number of examples of arrangements an investment adviser could reach with a client that do not involve voting on all or even most proxy matters.<sup>14</sup> Finally, the guidance conveys the SEC’s expectations for investment advisers to engage in ongoing oversight of proxy advisors on relevant issues.

Glass Lewis’ experience is that its clients take their oversight responsibilities very seriously. Glass Lewis devotes substantial resources to regularly engaging with its clients as they carry out their due diligence by answering oral and written questions, providing written materials and facilitating visits to its office sites.

In addition to oversight by their investment adviser clients, proxy advisors hold themselves accountable to a set of best practices principles designed specifically for the proxy advisor industry. These principles have grown out of a number of regulatory consultations around the globe on the role of proxy advisors in recent years. Recognizing that proxy advisors are a voluntary, private-market response to investors’ need for independent, cost-effective advice, most jurisdictions to study these issues have concluded that encouraging the development of best practices, rather than government regulation, was the appropriate response.

Most notably, in 2013, after a public consultation, the European Securities and Markets Authority (“ESMA”) found no evidence of a market failure and therefore did not see a need for binding or quasi-binding regulation of proxy advisors.<sup>15</sup> Instead, ESMA said the “appropriate

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<sup>13</sup> August 2019 Guidance.

<sup>14</sup> August 2019 Guidance at 9-12. In late 2018, the SEC Staff also withdrew two no-action letters that corporate commenters had criticized as effectively encouraging investment advisers to use an independent proxy advisor as part of fulfilling their fiduciary duty when they may have a conflict in voting on behalf of a client. See U.S. Securities and Exchange Commission, IM Information Update, Statement Regarding Staff Proxy Advisory Letters, IM-INFO-2018-02 (Sept. 2018).

<sup>15</sup> See Press Release, “ESMA recommends EU Code of Conduct for proxy advisor industry,” (Feb. 19, 2013), available at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-240.pdf>; see also U.S. General Accountability Office, Report to Congress, Corporate Shareholder Meetings—Proxy





approach” was for the industry to develop a code of conduct, to be applied on a comply-or-explain basis that would address two areas of concern raised in the consultation: 1) identifying, disclosing and managing conflicts of interest; and 2) fostering transparency to ensure the accuracy and reliability of the advice.

In response, Glass Lewis and other leading proxy advisors formed the Best Practice Principles Group (“BPPG”) to develop a code of conduct (“Principles” or “Code”) for the industry, which the signatories to the Principles said they would apply globally. The BPPG developed the Principles with input from ESMA and other stakeholders, including numerous issuer respondents to the consultation from both Europe and North America. Following a global, public consultation, the Principles were officially launched in March 2014.<sup>16</sup>

The Principles encourage transparency, conflict management and disclosure and engagement with companies when appropriate. Glass Lewis meets the Principles’ standards by making the following publicly available on its website: full guidelines; research approach and methodologies; conflict avoidance and disclosure policies; and public-company engagement procedures. Since the launch of the Principles, Glass Lewis and the other charter signatories have each published their Statements of Compliance, featuring detailed information on how the organizations comply with the Principles. Glass Lewis applies the Code to its activities globally, including in the United States, and updates its Statement of Compliance annually.

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Advisory Firms’ Role in Voting and Corporate Governance Practices, at 11 (Nov. 2016) (“GAO 2016 Report”) (“In recent years, [ESMA and the Canadian Securities Administrators] conducted reviews of the proxy advisory firm industry and concluded that *regulatory intervention was not needed*. Specifically, the European Securities and Markets Authority concluded that regulation was not justified because there was *no evidence of a market failure in relation to how proxy advisory firms interact with institutional investors and corporate issuers*. However, both entities proposed guidance and recommendations for the firms to enhance transparency, among other issues.”) (emphases added).

<sup>16</sup> More information on the BPPG is available on its website, see <https://bppgrp.info/>. In 2017, the charter signatories to the Principles conducted another public consultation to elicit market feedback on the extent to which the Principles were achieving their original objectives and to identify opportunities for improving understanding and transparency. An advisory panel, comprised of stakeholders from companies, asset owners, asset managers and other constituencies, provided input to the preparation of the consultation under the guidance of an independent chairman. Among other things, the latest update to the Principles addresses the transparency requirements for proxy advisors outlined in the EU DIRECTIVE 2017/828 of 17 May 2017 (“SRD II”) amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

To enhance its governance, per the recommendation of ESMA and complementary to the requirements of SRD II as well as stewardship developments in other markets globally, the BPPG is in the process of forming an Independent Oversight Committee. The Committee will be comprised of both investor and issuer representatives, as well as independent members, including an independent oversight Chair, to provide an annual independent review of the Principles and the public Statements of Compliance of each signatory and to hold all members accountable.

Glass Lewis continues to believe, consistent with the approaches chosen by ESMA, the Canadian Securities Administrators, the Securities and Exchange Board of India,<sup>17</sup> and most recently, the Financial Services Agency and the Tokyo Stock Exchange, through the Council of Experts on Japan's Stewardship Code,<sup>18</sup> that a market-based solution to proxy advisor oversight and accountability is appropriate. In particular, Glass Lewis believes that an industry code of best practices is the appropriate means to address the issuer concerns raised in the Proposing Release – namely accuracy, conflict management, transparency of policies and methodologies, and engagement. In our view, the existing standards of conduct, coupled with a mechanism to monitor and ensure compliance, would be a more appropriate way to address these issues and would best serve the interest of all market participants.

## **II. There is no need for the proposed rules.**

Our first concern with the proposed rules is perhaps the most basic — the Commission has not shown any need for them. The Release contains no empirical evidence showing a proxy advice error rate that warrants regulation, nor are we aware of any. In fact, the available evidence is to the contrary. Likewise, the Commission has not explained what is deficient about proxy advisors' current conflict disclosure practices to warrant the breadth and extent of the very prescriptive disclosures that would be required. Nor does it explain why proxy advisors' current issuer engagement practices, which include the ability for issuers to fact check the data

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<sup>17</sup> See "SEBI seeks public comments on Report submitted by the working group on Issues related to Proxy Advisers (PA)" (July 29, 2019) ("Establishment of and adherence to a global code of conduct, coupled with proper oversight by investors, has proven to be effective in ensuring the quality and integrity of proxy advisory research – without adding an undue burden on investors or inhibiting competition."), available at [https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments\\_43710.html](https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html).

<sup>18</sup> See newly proposed "Principle 8 of the Principles for Responsible Institutional Investors," (proposing a principles-based "comply or explain" approach in Japan's Stewardship Code), available at <https://www.fsa.go.jp/en/refer/councils/stewardship/20191220/01.pdf>.



used in the formulation of the proxy voting advice as well as the opportunity to provide feedback on the advice itself, are inadequate.

**A. There is no basis for claims of inaccuracy other than issuer concerns.**

The Proposing Release is premised on the proposition that radical changes are needed to how investors get proxy advice because of the current level of inaccuracy in proxy advisors' work. While Glass Lewis, of course, shares the Commission's goal of promoting proxy advice accuracy, the Commission has not come forward with evidence that proxy advisor inaccuracy is a problem, let alone one sufficient to warrant this regulatory response. The Proposing Release cites issuer "concerns" about inaccuracy — a term invoked dozens of times in the Release — but the Release does not evaluate or substantiate these issuer concerns in any meaningful way. In fact, as discussed further below, even the economic analysis only tabulates the number of instances in which issuers *claimed* there was a proxy advisor error, without purporting to confirm that any of these alleged mistakes were in fact errors. As one commenter has pointed out, "The paucity of evidence of systematic factual errors by proxy advisors suggests that, in fact, the opposite is true."<sup>19</sup>

As Commissioner Lee noted in dissenting from issuing the proposal, "What is missing in this proposal, however, are two critical underpinnings for the policy choices it reflects. First, it is missing data *demonstrating an error rate in proxy advice sufficient to warrant a rulemaking.*" In fact, not only is empirical evidence of a problem with proxy advisor accuracy missing, but, as Commissioner Lee noted, "[T]he proposal relies in large part not on specific instances of material factual inaccuracies, but on generalized, unsubstantiated allegations of inaccuracies."<sup>20</sup>

Nor did the Commission consider and rationally respond to evidence contradicting the issuer concerns cited in the Release. As Commissioner Lee again noted, "In fact, as the comment file shows, assertions of widespread factual errors have been methodically analyzed and largely disproven." Specifically, shortly before the proposal was issued, the Council of Institutional Investors ("CII") submitted a detailed analysis of the only industry report cited in the Release that purported to study proxy advisor errors (as opposed to surveys or generalized allegations). That industry report had found 39 claimed errors in proxy advisor reports over a

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<sup>19</sup> CII October 15 Letter at 3.

<sup>20</sup> See Statement of the Honorable Allison Herren Lee at SEC Open Meeting (Nov. 5, 2019), available at <https://www.sec.gov/news/public-statement/statement-lee-2019-11-05-shareholder-rights>.

nearly three year period.<sup>21</sup> CII analyzed each of the 39 situations, however, and reported its findings:

From our review of the filings that ACCF references, **it is clear that most of the claimed “errors” actually are disagreements on analysis and methodologies, and that some other alleged proxy advisory firm errors derive from errors in the company proxy statements. Finally, in some cases, ACCF simply misstates what the company said.** We think ACCF has documented no more than 18 reports with factual inaccuracies that can be blamed on proxy advisory firms, not the 39 that it claims.<sup>22</sup>

As CII pointed out, this amounts to “a factual error rate on a report basis of 0.057% to 0.123% (18 to 39 reports with one or more factual errors in 31,830 reports).”<sup>23</sup>

Nor does the Proposing Release account for the self-interest inherent in such issuer concerns. Proxy advisors are hired by investors to provide an expert, independent perspective on management recommendations. And while evidence shows proxy advisors generally agree with management recommendations 80-90% of the time, the remainder of the situations are instances where the proxy advisor sees the issue differently than management did. As one commentator noted, “Almost by definition, this means that recommendations that don’t agree with management are viewed as inaccurate, uninformed and value destroying.”<sup>24</sup> This obvious dynamic calls out for some agency scrutiny of these issuer claims. Instead, the Release credits those concerns without accounting for their holders’ perspective or the countervailing evidence.

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<sup>21</sup> Even these remarkably few reported errors were not substantiated; the report’s methodology involved assuming that if an issuer claimed a proxy advisor error, there was an error. See American Council for Capital Formation, “Are Proxy Advisors Really a Problem?,” at 11 (Oct. 2018), available at [https://accfcorgov.org/wp-content/uploads/2018/10/ACCF\\_ProxyProblemReport\\_FINAL.pdf](https://accfcorgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf).

<sup>22</sup> Letter of Ken Bertsch, Executive Director, Council of Institutional Investors to Chairman Jay Clayton, at 3 (Oct. 24, 2020) (“CII October 24 Letter”) (emphasis in original).

<sup>23</sup> CII October 24 Letter at 3. Of course, each report contains many different issues and even more individual data elements. On a per issue or data element basis, the error rate would be even lower.

<sup>24</sup> See Cappucci, “The Proxy War Against Proxy Advisors,” at 30.

In sum, faced with issuer “concerns” and evidence that those concerns were overstated, the Commission did not evaluate whether the concerns were valid. The Commission simply noted the discrepancy and moved forward with proposing an unsubstantiated, costly and harmful new regulatory system to address the asserted concerns. We respectfully submit that reasoned agency decision-making requires more than this.

Nor did the Commission assess the significance of the claimed errors in any way. Here, too, the Commission did not grapple with disconfirming evidence in its rulemaking record. In 2016, GAO conducted an extensive review of issuers’ concerns about proxy advisors and specifically found that “[b]oth corporate issuers and institutional investors we interviewed said that the data errors they found in the proxy reports were mostly minor, but . . . some errors can lead to negative recommendations.”<sup>25</sup> The Release, however, despite extensively relying on GAO’s report, makes no mention of this. The SEC’s approach of merely relying on issuer concerns and not validating or evaluating the asserted concerns in any way does not shed any light on the significance of the asserted problem.<sup>26</sup>

To be sure, proxy advisors — however rigorous their processes and quality controls — do inevitably make some mistakes and not all mistakes are as trivial as the one cited above.<sup>27</sup>

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<sup>25</sup> GAO 2016 Report at 29; see also Broc Romanek, “Proxy Advisers Handbook for In-House Counsel,” at 22 (Jan. 2015) (“There’s a realm of type of errors, some significant — some not. Some are merely a matter of interpretation — differences in opinion — and not really errors. And some “errors” are really updates as developments occur at a company. Some might be changes not reflected in a company’s disclosures — so they are just additional data points not reflected in a SEC filing so the proxy advisers weren’t aware of them.”); see also Cappucci, *The Proxy War Against Proxy Advisors*, at 19 (describing an industry report that had included a survey of its members to find examples of proxy advisors’ inaccuracy: “Evidence of inaccuracies in proxy advisors’ research ranges from the trivial to the legitimately troubling. For example, on the lighter end, one executive noted that ISS’ report stated that ‘our CEO was ‘entitled’ to use company aircraft for personal travel, when in fact he is required to do so.’”).

<sup>26</sup> Cf. Hester Peirce & Jerry Ellig, “SEC Regulatory Analysis: A Long Way to Go and a Short Time to Get There”, 8 *Brook. J. Corp. Fin. & Com. L.* at 423-24 (2014) (criticizing basis for SEC rulemaking because “The SEC did not provide evidence . . . to support the proposition that inaccurate information is a significant problem.”), available at: <https://brooklynworks.brooklaw.edu/bjcfcl/vol8/iss2/>.

<sup>27</sup> Glass Lewis’ error rate is less than 1%. Its main competitor discloses a similar error rate. When Glass Lewis is notified of a purported factual error or omission in one of its research reports, Glass Lewis immediately initiates a review process of the notification and the report. If a report is updated to reflect any material revisions, new publicly-available disclosures by the



But this would be true of any professional adviser, especially one producing tens of thousands of reports on complex subjects a year. If the mere occurrence of some errors were enough, every professional service would warrant regulation. What is absent here is any evidence that there is a systemic or significant problem that warrants a regulatory response. Indeed, we note that even a group of House members who support proxy advisor regulation have written to the SEC as part of this rulemaking asking the SEC to produce empirical evidence of proxy advisor errors.<sup>28</sup>

The reality is that proxy advisors' clients already have the proper incentive to seek out accurate advice. After all, why would anyone — let alone a sophisticated institutional investor — voluntarily pay for advice that is rife with inaccuracies, especially when they are using it to inform how they vote on important matters that can affect their shareholder value? In fact, proxy advisors compete based on the accuracy of their advice. As one commenter put it, "Proxy advisors' business model depends on factual accuracy and their incentives are thus aligned with issuers and institutional investors alike."<sup>29</sup>

If market incentives were not enough, the SEC has repeatedly told investment advisers — most recently and definitively this past August — that they have a responsibility as a legal matter to evaluate the accuracy of proxy advisors' recommendations and their processes for correcting errors as part of their due diligence in using them as a service provider. Given the market incentives and legal responsibilities already in place, the SEC should have produced a

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issuer or the correction of a factual error, Glass Lewis notifies all clients that accessed the report or have corresponding ballots, regardless of whether the update affected any recommendations. There is no deadline for notification of a purported material factual error. Additionally, the exact nature of the report's updates and revisions are clearly described in the republished report. If an issuer notifies Glass Lewis of a relevant factual error or omission in a report, Glass Lewis will respond and address the issuer's comments and/or questions.

<sup>28</sup> See Comments of the Honorable Bryan Steil et al., U.S. House of Representatives, at 3 (Jan. 6, 2020) ("What does the empirical evidence suggest as to the prevalence of factual errors in proxy advisory services?"), available at <https://www.sec.gov/comments/s7-22-19/s72219-6616198-202955.pdf>

<sup>29</sup> CII October 15 Letter at 3; see also Cappucci, *The Proxy War Against Proxy Advisors* at 32-33 ("If proxy advisory services were really as riddled with errors, transparency problems, and conflicts as their critics allege, one might expect their clients to be leading the charge for reform. After all, they are the ones paying for the supposedly faulty research and it is their shareholder value that is being harmed. But institutional investors and asset managers are not complaining.")



compelling conceptual and empirical basis for believing proxy advisor inaccuracy was a sufficient concern to warrant a new regulatory regime. Instead, the Release provides neither.

**B. The SEC has not explained why current conflict disclosures are inadequate.**

The Release is similarly vague about why current conflict disclosures are inadequate. As to conflicts, like accuracy, there are both market incentives and existing legal requirements to promote conflict avoidance and disclosure. Today, proxy advisors actively compete on the basis of the rigor of their conflicts policies and Glass Lewis takes pains to fully and prominently disclose even potential conflicts of interest.<sup>30</sup> In addition, investment advisers that vote proxies on behalf of their clients have a legal responsibility under SEC rules to monitor and understand their proxy advisor's ability to identify and address any conflicts of interest, including a responsibility to monitor this issue on an ongoing basis. Also, Exchange Act Rule 14a-2(b)(3) — an existing exemption available to proxy advisors — already requires disclosure of significant relationships and material interests.<sup>31</sup>

Given this background, one would expect there to be a compelling reason for instituting a new disclosure regime. But the Release does not clearly explain what is deficient about current proxy advisor conflict disclosures. In fact, in explaining the conflicts disclosure provision, the Release says that the “Commission’s primary concern in proposing these amendments to Rule 14a-2(b) is with the recipients of proxy voting advice, including investment advisers who use that advice to make voting decisions on behalf of clients with whom they have a fiduciary relationship.”<sup>32</sup>

This statement is hard to reconcile with the administrative record before the agency, however, which shows that those investment adviser clients are satisfied with current proxy advisor conflict disclosure practices. As the Investment Adviser Association stated:

Some commentators point to conflicts of interest as grounds for regulation of proxy advisory firms. However, . . . proxy advisory firms currently disclose their conflicts of interest transparently in a manner sufficient for investment advisers to review and evaluate them. Accordingly, this issue does not present a basis for a wholesale new and

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<sup>30</sup> See Glass Lewis’ Policies and Procedures for Managing and Disclosing Conflicts of Interest (May 9, 2019), available at <https://www.glasslewis.com/wp-content/uploads/2019/11/GL-Policies-and-Procedures-for-Managing-and-Disclosing-Conflicts-of-Interest-050819-FINAL.pdf>.

<sup>31</sup> See Exchange Act Rule 14a-2(b)(3)(ii), 17 C.F.R. 240.14a-2(b)(3)(ii).

<sup>32</sup> Release at 34 n. 91.



burdensome regulatory regime that would raise costs substantially and make it more difficult for other proxy advisory firms to enter the marketplace.<sup>33</sup>

Nor does the Release give any reason to think that proxy advisor clients could not insist on better conflict disclosures if they thought the current ones were inadequate. They could and would, of course, if they thought more extensive or detailed conflict disclosures would be helpful or warranted.<sup>34</sup>

Instead, the Release here too cites the concerns of issuers, their advisers and advocacy groups.<sup>35</sup> What the Release does not explain is why they — and not the proxy advisors' clients — should be the ones to evaluate whether those clients are receiving enough information or what additional disclosure would be useful. As one commentator has noted, “It is not clear what, if any, additional information critics are looking for when they call for greater disclosure,

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<sup>33</sup> See Letter from Gail C. Bernstein, General Counsel, Investment Adviser Association, at 5 (Dec. 31, 2018), available at <https://www.sec.gov/comments/4-725/4725-4840960-177135.pdf>.

<sup>34</sup> See also Comments of Simon Frechet, Chair, Pension Investment Association of Canada (Jan. 23, 2020) (“we agree that it is beneficial to receive disclosure of relationships, transactions, or other interests that might result in a conflict between the interests of a proxy advisor and those of shareholders. However, we have found the disclosures already provided to be adequate and have not encountered significant conflict of interest problems with proxy advisors, so do not believe that specific rulemaking is necessary to address disclosures of conflicts by proxy advisors.”); Comments of Sarah Wilson, Chief Executive Officer, Minerva Analytics (Jan. 2, 2020) (“If fund managers or institutional investors need protecting from proxy analysts, then we should be extremely worried for the rest of the investment management process for which they are responsible. Asset managers and institutional investors make many significant and demanding decisions every day – the allocation of trillions of Dollars, Pounds and Euros is their daily routine. Are issuers really suggesting that when it comes to ownership decisions that investors suddenly become ignorant?”).

<sup>35</sup> The only apparent non-issuer group cited in this section of the Release is a letter filed in a rulemaking on compensation consultant disclosure over ten years ago in which a fund group expressed concern about proxy advisor consulting for issuers (while recognizing that not all proxy advisors engage in this practice) and recommended that *issuers* be required to disclose consulting services they receive from proxy advisors. In fact, the commenter seemed to recognize that additional disclosure from the proxy advisor in the circumstances would have been counterproductive. See Release at 29 n. 78 (citing the comment letter of John Okray, Vice President and Assistant Counsel, Oppenheimer Funds, Inc. (Sep. 24, 2009)).

and whether they would ever be satisfied that the proxy advisors have provided enough disclosure.”<sup>36</sup>

Indeed, the Release itself is not clear about what additional information proxy advisor clients need.<sup>37</sup> The most specific references are to “observers” asserting that there are “vague” or “boilerplate” disclosures. This appears to be a reference to ISS’s deliberate conflict mitigation practice of saying that it may have provided consulting services to an issuer in order to prevent its analysts from knowing that is the case. In any event, if there was a legitimate concern about some proxy advisors using boilerplate, the SEC could have addressed that issue in more direct and less intrusive and costly ways. For example, it could have simply added this as an interpretation of either investment advisers’ existing responsibility or the existing solicitation exemption in its August releases or even used less formal and costly measures than a new rule to achieve its objectives.<sup>38</sup> The Commission has not adequately explained this concern and why it necessitates a costly, overly broad and highly prescriptive new disclosure regime.

**C. The SEC has not explained why existing mechanisms for issuers to express their views are inadequate.**

Similarly, the Release talks about providing “more complete” information to justify the new mandate that proxy advisors include a hyperlink to any issuer response in their proxy voting advice. The Release notes that issuers today can make a supplemental proxy filing to respond to proxy advice, and that, in fact, a number of issuers use this existing mechanism

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<sup>36</sup> Cappucci, *The Proxy War Against Proxy Advisors*, at 29.

<sup>37</sup> For example, the Release states, “Although proxy voting advice businesses have described various measures they believe mitigate this risk,[citing ISS and Glass Lewis conflict disclosure policies] the voting decisions of persons who rely on these businesses would be better informed if they received information sufficient for them to understand and assess these potential risks and measures.” Release at 28-29. This is a circular statement and simply begs the question of what information not being supplied today should be provided. If investors are not receiving sufficient conflict disclosures, it is incumbent on the agency to articulate how and why they are not sufficient (notwithstanding investors’ lack of concern) and how the proposed rules would address that problem.

<sup>38</sup> Cf. Peirce and Ellig, 8 *Brook. J. Corp. Fin. & Com. L.* at 424-25 (“To the extent adequate information is not being provided, the SEC could have considered working with the industry on a voluntary effort to establish best practices for disclosure to investors and potential investors.”).



every year. But the Release says, “The efficacy of these responses may be limited” because investors may choose to vote before those responses are sent.<sup>39</sup>

The SEC does not, however, say how often this is the case or purport to identify any useful, important new information in these supplemental proxy filings that was ignored. Most tellingly, the SEC offers no explanation as to why institutional investor shareholders would be acting contrary to their economic interest by voting on corporate governance matters at companies they own without useful information. Absent identification by the SEC of important, new information in these supplemental proxy filings that is not being considered today, the SEC has no rational basis, let alone a compelling reason, to mandate the novel and intrusive hyperlink requirement.<sup>40</sup>

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In sum, despite the clamoring of interested parties, there is little evidence of a need for any new rule, let alone the sort of compelling empirical evidence that would justify risking this wholesale, new and untested regulatory intrusion into institutional investors’ access to proxy advice.

### **III. The proposed rules would impair Glass Lewis’ ability to provide timely and independent advice to its clients.**

To meet investors’ needs, proxy advice must be timely and independent. We are concerned that the proposed rules could impair both of these critical elements of our work.

#### **A. The two-stage issuer review and feedback procedures, if workable at all, would significantly impair proxy advisors’ ability to provide timely advice.**

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<sup>39</sup> Release at 53.

<sup>40</sup> Nor has the SEC explained why, if it did have evidence that investment advisers were ignoring important information in voting, that would not be better and more directly addressed through additional guidance on investment advisers’ duty to vote in the best interest of their clients.



We do not believe that the two-stage issuer review mechanisms are workable.<sup>41</sup> For the 4,912 companies that would be eligible for one of the two review periods,<sup>42</sup> the rule would impose a minimum of five and, depending on how weekends fall, potentially up to eleven days of issuer review time into the middle of what is already a highly compressed process. There simply is not enough time for a week or more of issuer review in the process as it exists today. As the Investment Adviser Association warned at the Commission's Proxy Process Roundtable, mandatory issuer advance review of proxy advisors' reports "is not likely to work in practice."<sup>43</sup>

The lengthy mandatory periods, combined with the logistical challenges of administering the review processes, risk compromising investors' ability to obtain proxy advice based on their selected policies and submit their votes. The "best case scenario" will be material, adverse effects on investors' time to consider reports, engage with management and make their voting decisions.<sup>44</sup> It will also impose significantly increased costs. And, because the rule operates in a mandatory, rigid fashion, these delays and adverse effects will occur even when the issuer has no intention or interest in reviewing the proxy advice.

The unworkability of the mandatory review and feedback periods is exacerbated by the seasonality of the proxy advice business. Glass Lewis statistics show that more than half of the

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<sup>41</sup> We recognize that the Release refers to the second review stage as provision of a "final notice." There is no prohibition on issuers responding to this notice with additional comments or even new arguments, however. And the Release explicitly warns proxy advisors that failure to incorporate issuer comments could precipitate legal action under Rule 14-9. As Commissioner Lee noted, "There are two levels of review. The second one is called a "final notice" but it will function in the same way as the first review." See Statement of the Honorable Allison Herren Lee at SEC Open Meeting, at n. 6 (Nov. 5, 2019), available at <https://www.sec.gov/news/public-statement/statement-lee-2019-11-05-shareholder-rights>.

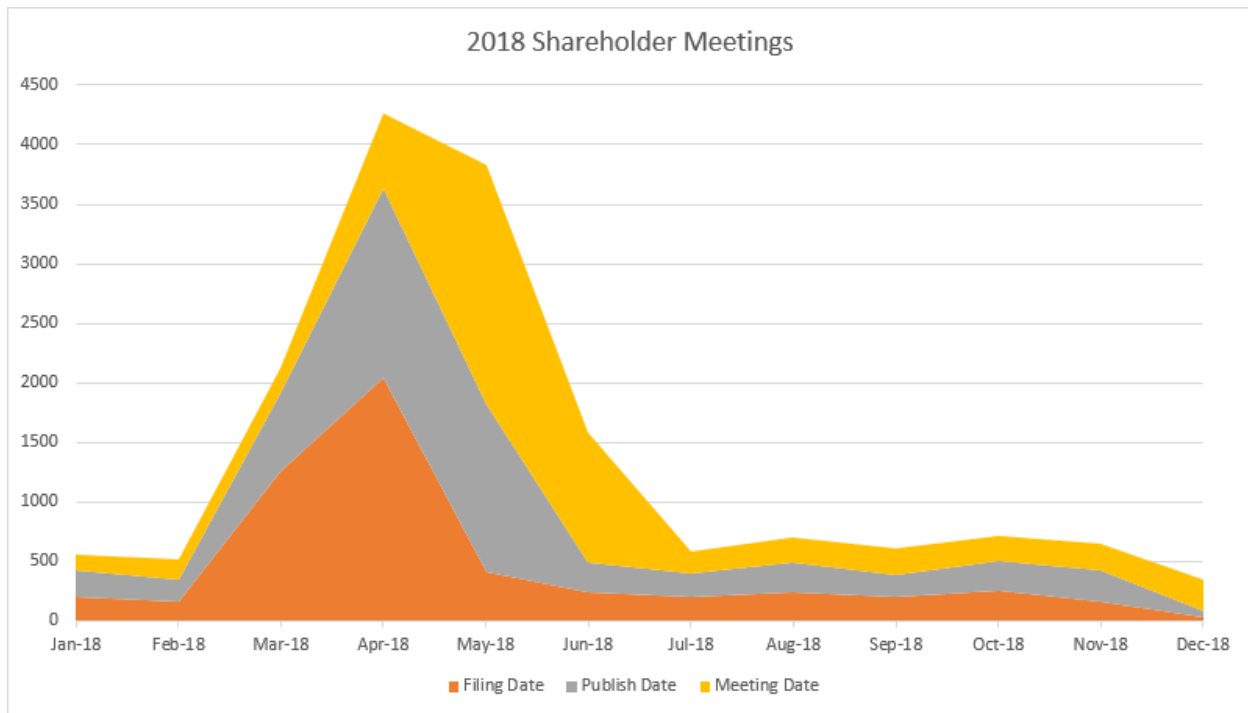
<sup>42</sup> Glass Lewis' analysis of the timing of proxy statement filings indicates that approximately 4,912 of the 5,565 companies it issued proxy research reports on in 2018 would have been eligible for one of the two review periods. See Glass Lewis' PRA Submission at 20.

<sup>43</sup> See Comments of Gail C. Bernstein, General Counsel, Investment Adviser Association at 5 (Dec. 31, 2018).

<sup>44</sup> See Comments of Scott M. Stringer, Comptroller, City of New York, at 2 (Nov. 20, 2019) ("Our capacity to fulfill our proxy voting responsibilities, particularly during the peak of U.S. proxy season in the spring, requires a high-quality, efficient process which rests in large part on the timely receipt of the independent, expert research we receive from our two proxy advisors (presently ISS and Glass Lewis).")



annual meetings it advises on in the U.S. each year take place in April and May.<sup>45</sup> And the number of meetings that must be covered over those two months is over six times as high as Glass Lewis’ average workload over the ten months outside the peak of “proxy season.” Glass Lewis data below illustrates how pronounced the concentration of proxy work in the late Spring is:



Administering the mandatory review and feedback processes during the peak time period would be, at best, extraordinarily challenging.

Yet the time periods in the proposed rules are fixed; issuers would be entitled to the same number of review days — potentially up to 11 — whether it is the busiest or least busy time of the year for corporate annual meetings. And the Release, while it does note in passing that a “significant portion of [investment advisers’] voting decisions [are] concentrated in a period of a few months,” does not otherwise engage with this issue, let alone provide a compelling, reasoned explanation of how the fixed review periods would be workable during peak proxy season.

<sup>45</sup> In 2018, 3,096 of 5,565 meetings or 55.6%.



Nor does the Proposing Release adequately consider the adverse effects these review periods would have on investors. The point of the proxy voting process, after all, is to facilitate shareholders' decisions on important corporate governance matters. A direct consequence of the proposal, however, would be to significantly decrease the time available for institutional investor shareholders to conduct their own analysis (including directly engaging with the company, if warranted) and make those decisions.<sup>46</sup>

Specifically, Glass Lewis studied the current timelines for its provision of proxy advice to its clients for the time periods used in the SEC's proposed rule, and a subset of one period where time pressure is most acute. Assuming that Glass Lewis' preparation time remained constant and responding to issuer feedback and carrying out the other administrative steps required by the proposed rules, including entering into confidentiality agreements with issuers, would take Glass Lewis three calendar days, the proposed rule would have the following effect on its clients' time:

Time Period (Calendar Days Before AGM Proxy Statement is Filed)	Investor Lead Time with Glass Lewis Research Today (Calendar Days to AGM)	Best-Case Average Lead Time Under Proposed Rules (Calendar Days to AGM)	Worst-Case Average Lead Time Under Proposed Rules (Calendar Days to AGM)
>45 days	27	17	13
25-45 days	24	16	12
25-30 days	21	13	9

As can be seen, in all but the best-case scenarios, the rule will often cut investors' time for analysis, engagement and deliberation by half or more. Because there are only five days in the work week, it will not be uncommon for one or both issuer review periods to include a weekend. In the critical segment of companies that file their proxy statements between 25 and 30 days before the annual meeting — a segment that the SEC speculates could grow as

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<sup>46</sup> Beyond the lost time, investors and others are concerned that focusing the process on proxy advisor-issuer exchanges would exacerbate the misconception that companies should be concerned with proxy advisors' views, rather than those of their shareholders. See Comments of Sarah Wilson, Chief Executive Officer, Minerva Analytics (Jan. 2, 2020) ("Issuers will feel that in having dealt with proxy analysts there will be less need for them to engage directly with their shareholders."); see also Securities and Exchange Board of India, Report of Working Group on Issues Concerning Proxy Advisors, at 25 (July 29, 2019) ("SEBI Working Group Report"), available at [https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments\\_43710.html](https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html).



companies seek to take advantage of the review periods — investors would lose between 38 and 57 percent of the time they have today before the meeting.<sup>47</sup>

Ironically, the SEC just this past August issued guidance conveying enhanced expectations for investment advisers' diligence in exercising voting responsibilities on behalf of their clients. Among other things, the August 2019 Guidance talked about situations where advisers may need to "conduct a more detailed analysis than what may be entailed by application of its general voting guidelines," and "to consider factors particular to the issuer or the voting matter under consideration."<sup>48</sup> At the same time, the proposed rules would dramatically shorten the time for investment advisers to comply with these responsibilities. As the New York City Comptroller stated, "We do not want company management interposed between us and our research service providers, and this is even more problematic if it involves additional cost and delay, giving us less time for our due diligence on each proxy vote."<sup>49</sup>

This is not only unwise, but unnecessary. Glass Lewis, like other proxy advisors, already has incentives to produce accurate research and therefore has designed and implemented processes where it can check key facts with issuers without compromising its time to research and write its reports or cutting into its clients' time to review the analysis and vote. Specifically,

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<sup>47</sup> Glass Lewis' data shows that report preparation and delivery timing varies significantly for mergers and acquisitions and other special situations. On average, proxy research reports were delivered to clients 14 days before the meeting date on M&A transactions and 13 days in contested situations. The review and feedback periods would obviously reduce the available time for our clients in these situations dramatically. In addition, our experience is that contested situations are often much more fluid with both sides making supplemental filings on a continuing basis as the meeting date approaches. In light of this, it is important for a proxy advisor, when appropriate to best meet its clients' needs, to be able to defer providing its advice until near-final information is available and to be able to quickly amend already-provided advice, as needed. For these reasons, we believe the review and feedback periods are particularly unworkable in this context. In addition, we note that commentators have raised significant questions about how the advance knowledge gained in the review processes could be misused in contested situations that should be addressed and resolved before adopting any rule mandating review in this context. See Ronald Orol, "Activist Spotlight: SEC Rule Could Give Activists an Advantage" (Dec. 2, 2019) (noting that proxy solicitation experts said there would be "many unintended consequences associated with the early access" in contested Board elections, including potential trading based on material non-public information).

<sup>48</sup> See August 2019 Guidance at 14.

<sup>49</sup> Comments of Scott M. Stringer, Comptroller, City of New York, at 3 (Nov. 20, 2019).





in 2015, Glass Lewis began to provide the subjects of its research with its Issuer Data Report (“IDR”), which details the key facts underlying the relevant report for their review before the report is finalized. This practice is deliberately limited. Glass Lewis finds that by providing the facts underlying the report, it can gain any benefit of company review without inviting time-consuming and unproductive debates about Glass Lewis’ methodology or what result that methodology should lead to in the context of a particular recommendation.<sup>50</sup> This free service has been available for several years and more than 1,400 companies currently participate in it on an annual basis. The proposed rule, however, would replace this carefully designed, tested and efficient workflow with two mandatory rounds of issuer review of both facts and recommendations.

Moreover, the SEC has invited companies to use their review periods to challenge proxy advisors’ methodology, with the suggestion that lawsuits could be based on proxy advisors not incorporating issuer “feedback.” This means that, along with the five to eleven days of issuer review time, proxy advisors will need to devote time during this compressed period to respond to distracting and unproductive challenges by management to its methodology and potentially document its reasons for why it did not revise its proxy advice, in anticipation of litigation.

The review and feedback mechanisms are not workable and should be abandoned. If they are not, the SEC should explain its basis for believing that this major change would not disrupt the proxy voting process, even during the peak proxy season. In addition, having a reasoned basis for the rule requires accounting for the opportunity costs of: 1) constricting the time for investors to conduct their own proxy review process, including reviewing proxy advisor reports, engaging with companies, and determining how to vote; and 2) making it more difficult for proxy advisors, if needed, to expand the amount of work they do to engage in deeper research on particularly complex issues. Absent seeing such a compelling explanation, we respectfully submit that the risks and adverse consequences of the rule far exceed any benefits to issuers.

#### **B. The issuer review and feedback procedures would compromise proxy advisors’ independence.**

Independence is fundamental to the proxy advisor’s role. Most parties involved in the proxy solicitation process have an interest in the outcome. As annual meetings approach, company management and sometimes others try to persuade shareholders to support their position. In contrast, institutional investor shareholders hire proxy advisors to be a neutral,

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<sup>50</sup> We note that this is similar to the approach taken in the context of research analysts, where, as further discussed below, SEC-approved FINRA rules allow them to check the facts in their reports with companies, but not share the full reports.

disinterested arbiter. They want an expert who can sort through dense, lengthy and complex proxy statements and, with no interest other than aiding the shareholder client, help them come to a vote consistent with their investment philosophy and voting policy.<sup>51</sup>

The rule, however, seems intended to — and almost certainly would — damage this very independence and neutrality. The proposal’s new regime would create three new ways for company management to try to influence the work of or even punish proxy advisors who recommend against their proposals: the review and feedback procedures; the mandate to publish management views; and the Damocles’ sword of potential company litigation. In other words, as Commissioner Jackson put it in dissenting from issuing the proposal, the proposed rule “imposes a tax on firms who recommend that shareholders vote in a way that executives don’t like.”<sup>52</sup>

From an investor’s perspective, the previously objective advice they paid for would now be potentially conflicted. As the Comptroller of the City of New York and trustee of the New York City Retirement Systems commented on this proposal: “While proxy advisory firms should, and do, have procedures in place to mitigate any potential conflicts of interest, I can conceive of no conflict of interest more insidious than the one created by a Proposal that would

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<sup>51</sup> See Nell Minow, Value Edge Advisors, “Response to the Chamber of Commerce’s Outrageous Comment to DOL, Harvard Law School Corporate Governance Blog (Oct. 30, 2019) (“Proxy advisory firms are the only independent source for evaluation of proxy issues.”), available at <https://corpgov.law.harvard.edu/2019/10/30/response-to-the-chamber-of-commerces-outrageous-comment-to-dol/>.

<sup>52</sup> Statement of the Honorable Robert J. Jackson, Jr. at SEC Open Meeting (Nov. 5, 2019), available at <https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-openmeeting>; see also Matt Levine, “Advice is Different than Solicitation,” Bloomberg Opinion (Nov. 6, 2019) (“if [proxy advisors] get stuff wrong by [] managers’ standards, those managers can now make life hard for them. Whereas if they just do what the managers want there’s no problem.”), available at <https://www.bloomberg.com/opinion/articles/2019-11-06/advice-is-different-from-solicitation>; Cappucci, The Proxy War Against Proxy Advisors, at 30-31 (“Further, giving companies an additional say in the process could have a chilling effect on proxy advisors’ willingness to issue truly independent advice. If they believe that every disagreement over a subjective determination like a say-on-pay vote is likely to lead to a messy confrontation with management, they may be less inclined to issue negative advice.”).



grant a company that is the subject of proxy voting advice the right to review and provide feedback on that advice.”<sup>53</sup>

In fact, the SEC has acknowledged that issuer review presents a conflict of interest in an analogous context. At the Open Meeting at which the Commission proposed these rules, Chairman Clayton noted that proxy advisors’ services to investment advisers “are comparable to the services of other significant third-party market participants on whom shareholders rely, including auditors, rating agencies and research analysts.”<sup>54</sup> But the SEC was presented with this very issue in the context of regulating analysts<sup>55</sup> and, rather than *mandating* issuer review, agreed that it should be *prohibited* because of the conflict it presents.

With the SEC’s oversight and express approval, the Financial Industry Regulatory Authority (“FINRA”) has promulgated rules that regulate the conflicts of interest research analysts face in researching and reporting on the advisability of investing in public companies.<sup>56</sup> While many of its research analyst rules are disclosure-based, FINRA Rule 2241 requires broker-dealers to have policies and procedures that “prohibit prepublication review of a research

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<sup>53</sup> Comments of Scott M. Stringer, Comptroller, City of New York, at 3 (Nov. 20, 2019); Comments of Sarah Wilson, Chief Executive Officer, Minerva Analytics (Jan. 2, 2020) (“Various commentators have claimed that lack of objectivity and independence and so therefore issuers must have the last word. This does not make sense. If research becomes conflicted or tainted by the involvement of issuers in the research process because they are buying, receiving or commenting on research then surely there should be less involvement, not more?”).

<sup>54</sup> Statement of the Honorable Jay Clayton at SEC Open Meeting (Nov. 5, 2019) (footnote omitted), available at [https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting#\\_ftn13](https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting#_ftn13).

<sup>55</sup> Analysts are third parties who produce research reports for investors with investment recommendations. Proxy advisors are third parties who produce research reports for investors with corporate governance recommendations.

<sup>56</sup> As FINRA has explained, “[t]he aim of FINRA’s equity and debt research analyst and research report rules is to foster objectivity and transparency in research reports and public appearances and provide investors with more reliable and useful information to make investment decisions.” FINRA, Rules and Guidance, Research Analyst Rules, available at <https://www.finra.org/rules-guidance/key-topics/research-analyst-rules>.

report by a subject company for purposes other than verification of facts.”<sup>57</sup> As a senior SEC official explained at the time the rule was promulgated:

Analysts will also be prohibited from sharing draft research reports with the target companies, other than to check facts after approval from the firm's legal/compliance department. *This provision helps protect research analysts from influences that could impair their objectivity and independence.*<sup>58</sup>

But here, the proposed rules would require the very conflict that is prohibited in this comparable situation. In other words, under the federal securities laws, it is illegal for an analyst to do what proxy advisers would be required to do by the proposed rule. Administrative law, fundamental fairness and common sense require that comparable services should be regulated in comparable fashion.<sup>59</sup> At a minimum, the SEC should not mandate something that presented a sufficient problem in a comparable context that it had to be prohibited.<sup>60</sup>

**C. Treating methodology the same as facts is conceptually flawed and will lead to unproductive disputes.**

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<sup>57</sup> FINRA Rule 2241(b)(2)(N). Our understanding is that the SEC has approved this rule twice, first as NASD 2711 and then, slightly amended, as FINRA 2241 in 2015. See U.S. Securities and Exchange Commission, Release No. 34-34-75471 (July 16, 2015).

<sup>58</sup> Speech of Lori Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange, “Analysts Conflicts of Interest: Taking Steps to Remove Bias,” (May 8, 2002) (emphasis added), available at <https://www.sec.gov/news/speech/spch559.htm>.

<sup>59</sup> See also Statement of the Honorable Elad L. Roisman at SEC Open Meeting (Nov. 5, 2019), (“the same activity should be regulated consistently across our markets”), available at [https://www.sec.gov/news/public-statement/statement-roisman-2019-11-05-14a-2b#\\_ftnref4](https://www.sec.gov/news/public-statement/statement-roisman-2019-11-05-14a-2b#_ftnref4).

<sup>60</sup> Among the comparable professional services Chairman Clayton referred to, only proxy advisers would be singled out for mandatory pre-review of their reports by the subject companies. In fact, these other services are primarily regulated to **prevent** direct or indirect management influence on the objectivity of their advice. Nor would it would suffice for the SEC to seek to distinguish research analysts because of the history of scandals in that field. Just because FINRA and the SEC had to step in and prohibit a conflict after a scandal in one context does not make it rational to mandate that same conflict for a comparable service that has not been ridden with scandals.

Implicitly conceding that the oft-heard criticism of proxy advisors' work as being error-prone was baseless or at least misleading,<sup>61</sup> the Release consistently refers to "factual errors or methodological weaknesses" in describing issuers' concerns and what the rule is meant to address. For example, the Release states that companies "may have disagreements that extend beyond the accuracy of the data used, such as differing views about the proxy advisor's methodological approach or other differences of opinion that they believe are relevant to the voting advice."<sup>62</sup>

The Proposing Release does not define the term "methodological weakness" or give any examples of them. Nor does the economic analysis try to identify methodological weaknesses as a category of issuer complaints, although it does identify what are called "analytical errors" and "general or policy dispute[s]." (We note that there were nearly five times as many of these as purported "factual errors" in the analysis' sample.) But issuers are nonetheless invited to review and provide feedback on "methodological weaknesses." There are at least three problems with this.

First, methodology does not lend itself to this type of review. Methodology is different than facts in the sense that it is judgmental. For the most part, the issues that are put up for shareholder vote on corporate proxy statements are matters of opinion on which there is not a right or wrong answer.

In fact, this very point has been made by the Commission. In 1992, the SEC was confronted with management arguments for a "role to play in rebutting any misstatements or mischaracterizations" made about their company in the proxy process. Companies maintained that this was necessary for "the benefit of shareholders as a whole in ensuring that proxies are

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<sup>61</sup> This is widely recognized outside of corporate-funded studies. See, for example, SEBI Working Group Report, at 10 ("While there have been arguments that proxy advisors are not open to factual corrections, we found factual errors both rare and non-contentious. The most contentious issues where a company strongly disagreed with a recommendation is almost always an opinion formed by the proxy advisor."); Broc Romanek, Proxy Advisers Handbook for In-House Counsel, at 11 ("There's a realm of type of errors, some significant - some not. Some are merely a matter of interpretation-differences in opinion-and not really errors.").

<sup>62</sup> Release at 43-44. Similarly, the Commission's August 2019 Interpretation maintained that the Rule 14a-9 cause of action extends to "opinions, reasons, recommendations, or beliefs." Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019) ("August 2019 Interpretation").



executed on the basis of ‘correct’ information.”<sup>63</sup> But the SEC rejected this argument because the types of issues that come up on corporate proxy statements are not the sort that lend themselves to this kind of review. As the Commission explained at that time:

Of course, much commentary concerning corporate performance, management capability or directorial qualifications or the desirability of a particular initiative subject to a shareholder vote is by its nature judgmental. As to such opinions, there typically is not a ‘correct’ viewpoint.<sup>64</sup>

This is no less true today. But the SEC has not acknowledged this prior position, let alone provided a reasoned basis for its change of position.

The judgmental nature of many issues on the corporate proxy is confirmed by evidence of major investors’ voting patterns. Today, “[t]here is considerable variation in asset manager voting on shareholder proposals,” even among the largest and most sophisticated institutional investors.<sup>65</sup> In the frequent scenario when even the largest investors disagree on the merits of a shareholder proposal, it would be naive to attribute those differences to “methodological weakness” on the part of one of the investors. Rather, major investors’ voting patterns reflect the judgmental nature of many issues up for proxy voting, which is precisely why encouraging company-proxy advisor disputes about methodology — up to and including litigation about proxy advisors’ opinions and recommendations — would be unproductive and wasteful.

Second, discussions on methodology are best conducted outside proxy season. A proxy advisor’s methodology is almost always applicable to more than one company. Accordingly, Glass Lewis finds it most efficient to obtain issuer input on its methodology outside of the peak proxy season, when its resources need to be focused on specific analysis and application of that methodology to annual meeting proposals.<sup>66</sup> But the review and feedback procedures would

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<sup>63</sup> U.S. Securities and Exchange Commission, Regulation of Communication among Shareholders, Release Nos. 34-31326 (Oct. 22, 1992), 57 Fed. Reg. 48,276 (“SEC Shareholder Communications Release”).

<sup>64</sup> Id. at 48,278.

<sup>65</sup> See Barbara Novick, BlackRock, Inc., “Proxy Voting Outcomes: By the Numbers, Exh. 5 (showing data from N-PX filings), Harvard Law School Corporate Governance Blog (July 24, 2019), available at <https://corpgov.law.harvard.edu/2019/07/24/proxy-voting-outcomes-by-the-numbers/>.

<sup>66</sup> For the year ended June 30, 2019, Glass Lewis analysts met with more than 1,600 companies on methodology and contacted more than 37,500 companies for feedback and input.



force these conversations to happen when there is the least time for them, with the attendant costs and risks for the proxy advice process discussed above.

Third, the focus on issuer-proxy advisor dialogue on methodology is misplaced. Proxy advisors are agents of and exist to serve their clients, the shareholders who actually vote on corporate proxies. Much of what proxy advisors do is to understand their clients' positions and voting policies, reflect the consensus positions in their house policies, and then, through careful review of proxy statements, apply those positions to the thousands of factual situations in which they arise each year. In other words, much of what proxy advisors do is to implement client voting preferences, whereas the proposal seems to assume that proxy advisors are causing investors to have those preferences.<sup>67</sup> Seen in this light, much of the feedback about "methodological weaknesses" that the proposed rule would steer to proxy advisors would be misdirected, particularly since "there typically is not a correct viewpoint" on these matters.

For this reason, the Release's asking whether the proposed rules should apply to custom voting policies is especially problematic and confusing. To begin with, we fail to see how this would work in practice. Glass Lewis administers custom voting policies on one or more issues for hundreds of clients, with none of those custom policies being reflected in a proxy research paper that could be provided to an issuer for its review. Doing this in some way would also have significant ramifications for the cost, time and paperwork burdens the rules would impose.<sup>68</sup>

Even if this could be operationalized, it would serve no apparent purpose. When a proxy advisor is implementing a client's custom policy, the vote recommendation reflects the client's position, not the proxy advisor's. Forcing a delay in that recommendation's delivery to the shareholder so that an issuer can explain to the proxy advisor why it thinks the client's policy has "methodological weaknesses" would be beside the point. By definition, the methodology being applied is different than the proxy advisor's benchmark policy. Under the proposed rules, would the proxy advisor be making a false or misleading proxy "solicitation" if it implemented the client's custom policy, just because that methodology is different than the one in its house policy? Because the proxy advisor is not exercising its own judgment when it

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<sup>67</sup> See Stephen Choi, Jill E. Fisch, and Marcel Kahan, "The Power of Proxy Advisors: Myth or Reality?," 59 Emory L.J. 869 (2010) ("Thus, ISS is not so much a Pied Piper followed blindly by institutional investors as it is an information agent and guide, helping investors to identify voting decisions that are consistent with their existing preferences.").

<sup>68</sup> Glass Lewis' PRA Submission assumed the proposed rules did not apply to implementation of a client's custom policy.



implements a client's custom policy, applying the proposed rules to that function would not make sense. The SEC should clarify in any final rule that "advice that makes a recommendation" does not include application of a client's custom voting policy.<sup>69</sup>

**D. The conflicts, review and feedback, and publication requirements need important technical fixes and clarifications to be operational.**

**1. The conflicts disclosure provision.**

Glass Lewis supports the Commission's objective of ensuring that proxy advisors appropriately manage and disclose conflicts and has always taken a rigorous approach to conflict avoidance and disclosure. In light of this and the existing legal requirements around proxy advisor conflict oversight and disclosure, we are not clear why a new, highly prescriptive conflict disclosure regime is warranted. If the Commission does move forward with this part of the proposal, however, we suggest that the proposed rule and accompanying release be revised in two respects to avoid unintended consequences.

First, we are concerned that the breadth of the definition of "affiliate" in the Proposing Release would have the unintended consequence of making Glass Lewis research analysts aware of relationships they are specifically shielded from today in order to avoid conflicts. Specifically, each of the three sub-sections of the proposed rule describing potential conflicts extends to any "affiliate" of the proxy voting advice business (as well as "affiliates" of the registrant or shareholder proponent it may have a material transaction or relationship with). And the Release explains that "affiliate" is meant to have the same meaning as Exchange Act Rule 12b-2, where it is defined as "a person that directly, or indirectly through one or more

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<sup>69</sup> As Question 33 in the Release seems to recognize, forcing "advice" in the form of implementation of a client's custom voting policy to be shared with issuers would also expose some investors' confidential, proprietary information. Many Glass Lewis clients publish or are comfortable making their voting policies public. Other clients, however, do not make their voting policies public and expect Glass Lewis to maintain their confidentiality. Mandating that custom voting recommendations go through the issuer review and feedback mechanisms would expose these investors' confidential, proprietary information and force Glass Lewis to breach its commitments to these clients. Carving custom policy implementation out of the proxy advice covered by the rule would avoid this problem. See also Comments of Pension Investment Association of Canada (Jan. 23, 2020) (applying the rules to custom policy implementation "would be extremely inappropriate. PIAC members have the right to make their own voting determinations and to keep their voting intentions private if they desire.").



intermediaries, controls, or is controlled by, or is under common control with, the person specified.”<sup>70</sup>

Glass Lewis is co-owned by the Ontario Teachers’ Pension Plan Board (“OTPP”) and Alberta Investment Management Corp. (“AIMCo”). Neither OTPP nor AIMCo is involved in the day-to-day management of Glass Lewis’ business; Glass Lewis operates as an independent company separate from OTPP and AIMCo. Moreover, Glass Lewis excludes OTPP and AIMCo from any involvement in the formulation and implementation of its proxy voting policies and guidelines, and in the determination of voting recommendations for specific shareholder meetings. To help maintain this separation, Glass Lewis’ policy on conflicts of interest provides in part: “Restricted Access to Owner Information. Glass Lewis research analysts are blocked from any access to the holdings files, custom policies, and/or voting activity of Glass Lewis’ owners.”<sup>71</sup>

As we understand the proposed rule, however, any company controlled by a Glass Lewis controlling owner would be considered an affiliate and therefore even an interest, transaction or relationship of that company with a registrant *or any registrant affiliates* would require conflict disclosure.<sup>72</sup> And the Release conveys the SEC’s expectation that “publicly-available information” would be used to search for affiliate relationships. This would seem to require an unnecessarily broad inquiry into matters Glass Lewis and its analysts are deliberately not given access to – with potentially significant associated costs and delay – and lead to disclosure of situations that would not present even an appearance of a conflict, particularly given the structural mechanisms in place.<sup>73</sup>

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<sup>70</sup> 17 C.F.R. 240.12b-2.

<sup>71</sup> Glass Lewis’ Policies and Procedures for Managing and Disclosing Conflicts of Interest (May 9, 2019), available at <https://www.glasslewis.com/wp-content/uploads/2019/11/GL-Policies-and-Procedures-for-Managing-and-Disclosing-Conflicts-of-Interest-050819-FINAL.pdf>.

<sup>72</sup> To be clear, Glass Lewis does disclose today when either of its owners has a stake in a company it reports on that is significant enough to be publicly disclosed in accordance with a local market’s regulatory requirements or is a Top 20 shareholder. Our point here is about the effect of using the broad “affiliate” definition on both the proxy advisor and the subject of its advice.

<sup>73</sup> Moreover, in certain situations, the interests, relationships and transactions required to be disclosed by such a broad definition of “affiliate” may implicate proprietary or potentially material non-public information.

Second, we question whether one aspect of the proposed disclosure is overbroad and therefore may risk obscuring the important information in the conflict disclosure. Specifically, sub-section (D) would require each proxy advisor report and electronic medium noting a conflict to include disclosure of “[a]ny policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship.” The Release describes this as requiring:

a discussion of the policies and procedures, if any, used to identify and steps taken to address such potential and actual conflicts of interest. Such disclosure should include a description of the material features of the policies and procedures that are necessary to understand and evaluate them. Examples include the types of transactions or relationships covered by the policies and procedures and the persons responsible for administering these policies and procedures.<sup>74</sup>

Although it is not clear to us exactly what is expected here,<sup>75</sup> we are concerned that including a “discussion” of Glass Lewis’ conflict policies and procedures twice with each conflict disclosure would be wasteful and potentially obscure the important information investors expect and would want to focus on. Glass Lewis has one set of policies and procedures that describes how it identifies and addresses conflicts, which it makes available on its website. The document is fairly lengthy and it is not readily apparent to us how it could be significantly condensed while still describing the “material features of the policies and procedures that are necessary to understand and evaluate them,” as the Release says each disclosure should. Moreover, since these policies and procedures apply to all conflicts, we do not see what value would be added by repeating them with each conflict disclosure as opposed to maintaining them on the website and perhaps including a reference to them with each conflict disclosure.<sup>76</sup>

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<sup>74</sup> Release at 32.

<sup>75</sup> We note that the SEC’s Investor Advisory Committee read this provision to require proxy advisors to disclose their detailed compliance manuals. If that is what is intended by this provision, it would be inappropriate and problematic for the reasons identified in the IAC submission. See Recommendation of the SEC Investor Advisory Committee (IAC) Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals, at 10 (Jan. 24, 2020).

<sup>76</sup> Moreover, the Release does not explain what purpose would be served by this disclosure including the name of the person or persons responsible for administering the policies and procedures. Glass Lewis discloses the management roles included on its Compliance Committee, which has overall responsibility for its conflicts program, as part of its conflict policies and procedures.

## 2. The issuer review and feedback mechanisms.

As noted above, Glass Lewis believes the issuer review and feedback mechanisms are unworkable and inadvisable. If the Commission nonetheless proceeds with this part of its proposal, we are also extremely concerned that these mechanisms fail to account for a number of basic, administrative details that would be critical for the rules to be operational. Having designed and managed our own factual review and comment mechanism (Glass Lewis' IDR program<sup>77</sup>), we are mindful of the complexity involved and the importance of designing the necessary processes in an efficient manner. Given the scale and novelty of extending two rounds of issuer review of facts and methodology to some 5,000 reports a year, we strongly encourage the Commission to address these issues and seek supplemental comment on their practical operation before finalizing any rules.<sup>78</sup>

Today, issuers seeking to participate in Glass Lewis' IDR process must indicate their interest a set period of time before the data is ready for their review. This facilitates Glass Lewis' planning and avoids wasted effort and lost time seeking factual review from issuers that have no interest in reviewing Glass Lewis' proxy advice. While many issuers sign up for and participate in the process, many others do not. In contrast, the rule would mandate three or five business days of review for most issuers. The review and feedback mechanisms should give proxy advisors' flexibility to not jump through these hoops when they would serve no purpose.

Including an opt-in on the issuer's part would also solve another seemingly mundane, but critical part of trying to carry out the review and feedback processes for some 5,000 issuers a year — knowing whom to provide the proxy advice to. The issuers covered by the proposed rule often have thousands of employees and the rule provides no guidance on whom it should be provided to or any assurance that sending it to any appropriate company employee whose contact information can be obtained would satisfy its requirements. Having issuers opt in would allow proxy advisors to collect this information before the process begins. Absent that, the Commission should amend the proxy statement to require issuers to specify a contact

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<sup>77</sup> Glass Lewis operates a program today where issuers have the opportunity to review a data-only version of the proxy research report — for free — prior to publication of the report to Glass Lewis' clients. See <https://www.glasslewis.com/issuer-data-report/>.

<sup>78</sup> Alternatively, if the Commission determines to move forward with the issuer review and feedback mechanisms, a pilot program outside peak proxy season would be an appropriate vehicle to test the rule's practical operation before extending these untested requirements to the entire proxy advice market.

person and clarify in the rule that proxy advisors need only provide a copy to the designated contact and consider feedback from that designated contact.

Both the three- and five-day issuer review periods require the proxy advisor to “provide[] . . . a copy” of the proxy advice to the registrant for review. The “final notice” requirement is phrased similarly. Given the enormous logistical burden the proposed rule’s mechanisms would cause, proxy advisors would almost certainly need to develop and implement software to try to carry out this back and forth process. For example, it might require developing an issuer-facing electronic platform that could host the drafts and facilitate the review and feedback process.<sup>79</sup> Framing this requirement in more general terms, such as “makes available to,” rather than “provides,” would enable proxy advisors to attempt to carry out the rule’s requirements in a less inefficient and costly manner.

Similarly, the rule should allow proxy advisors to specify how the feedback is transmitted, with express assurance in a note that proxy advisors are not obligated to consider feedback not provided through the designated channel. Issuers participating in Glass Lewis’ IDR process provide their comments in a specified format that increases the efficiency and auditability of the process. Failing to allow the proxy advisor to specify an appropriate channel for the communication of feedback puts the proxy advisor in the position of having to potentially query its entire workforce for any communication from any company employee (or their outside lawyers) before it can conclude an issuer has not provided feedback, which would be time-consuming and a recipe for missed communications.

The SEC should also clarify that the initial review period runs from when the proxy advisor makes the proxy advice available to the company, subject to the company signing a confidentiality agreement that is consistent with Note 2. The rule should also clarify that a registrant that does not agree to the proxy advisor’s standard confidentiality agreement for these purposes — not just “such an agreement,” as sub-section (B) of Note 2 in the proposed rule reads — would not be entitled to the review mechanisms. As highlighted by Glass Lewis’ PRA Submission, the vagueness of the current rule raises the prospect of proxy advisors having to negotiate confidentiality agreements with issuers, which could consume significant amounts of time. Moreover, if the review period does not commence while this negotiation is taking place, it could cause significant, further delays and potentially be used in an opportunistic manner by companies anticipating an adverse proxy advisor recommendation.<sup>80</sup>

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<sup>79</sup> The Release seems to recognize this might be the most efficient way to carry out the review mechanisms. See Release at 58-59 (discussing a 2018 BlackRock letter).

<sup>80</sup> Likewise, we fail to see what would be accomplished by forbidding provision of a final notice, assuming it was ready, before the initial review period ends even if the issuer has

Likewise, the rule's unexplained statement that any confidentiality agreement "[s]hall cease to apply once the proxy voting advice business provides its advice to one or more recipients" is inconsistent with proxy advisors' standard business terms and should be stricken. Proxy advisors' advice is their product. Accordingly, Glass Lewis' clients, whether they purchase an individual report or a subscription, are not allowed to redistribute its proxy research reports. There is no reason non-paying issuers should not be subject to the same restrictions and any final rule should strike this sentence and clarify that a proxy advisor has a right to protect its intellectual property in the same manner as it does with its paying clients.

The SEC should also clarify that multiple rounds of "final notices" are not required. The rule, as proposed, states the proxy advisor must give companies two business days with a final notice that "must include a copy of such proxy voting advice that the proxy voting advice business will deliver to its clients." The Release explains that "'will deliver to its clients' [] effectively requires that the version of voting advice included in the final notice of voting advice will be the actual voting advice that will be disseminated to clients."<sup>81</sup>

This is not workable, however. As we have previously noted, nothing in the rule prevents an issuer from commenting on the final notice and other events may happen that require changes to the proxy advice included in the final notice. As proposed, the rule would require that each time the intended final proxy advice changes (whether in response to issuer comment, an update, to correct an error, or otherwise), it triggers another requirement to transmit it to the company for another two business days of review, further delaying the client's receipt of the advice or even potentially inviting gamesmanship at the final notice stage. The rule should not penalize or discourage updates, corrections or just accommodation of issuer suggestions at this stage, when appropriate, and the Commission should therefore clarify that there is only one final notice stage, even if the proxy advice changes.<sup>82</sup>

If it preserves the two rounds of review, the Commission should also provide that standard "exhaustion" principles apply. Companies should be deemed to have waived any objections that they could have raised at the initial review stage, but did not, and should not be

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already provided its feedback. This seems to impose an arbitrary delay in the process, with no corresponding benefit we can discern.

<sup>81</sup> Release at 48 n. 121.

<sup>82</sup> As noted in our PRA Submission, we understand that the SEC Staff has acknowledged that the rule should not require multiple final notices and that this would be corrected in any final rule. Accordingly, our paperwork burden hour estimates assumed that revision will be made.

allowed to press these objections for the first time at the final notice stage (or, for that matter, in an action under Rule 14a-9).<sup>83</sup> As the Commission knows from its role as an appellate body, standard requirements that an argument be raised when a party is first aware of it — and the party it is presented to has the best opportunity to respond to it — are critical to the efficiency of any review process. Not including this standard principle would increase the chances objections are first raised at the final notice stage, reducing the opportunity for the proxy advisor to fully consider the objection, risking further delays to the delivery of proxy advice and inviting opportunistic misuse of what we understand the Commission intended by including the final notice.

The proposed rule should also contain appropriate guardrails around the use of non-public information. Glass Lewis’ analysis and reports are based solely on publicly-available information; under no circumstance does Glass Lewis develop its research or make vote recommendations based on non-public information. As drafted, however, there does not seem to be any prohibition in the proposed rule on an issuer providing non-public information as part of its feedback. The rule should require that any issuer information provided as part of the feedback process be publicly available, with the company’s feedback including appropriate citations to the public source for the information, such as the company’s filings. At the same time, proxy advisors cannot be in the position of having to research and assure themselves of the public nature of any issuer feedback they receive and decide to incorporate in their proxy advice. Accordingly, any final rule should make clear that the proxy advisor may incorporate into its analysis and distribute to its clients any information provided by the company as part of its feedback and that the proxy advisor is in no way liable for any adverse consequences stemming from dissemination of any information provided by the company as part of its feedback.

Many of these practical concerns could be addressed by moving to a principles-based rule and using Commission or Staff guidance to ensure that the mechanisms are being administered in a fair and efficient manner.<sup>84</sup> If the Commission determines to go forward with a detailed, prescriptive rule, we believe that successful resolution of these operational issues is

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<sup>83</sup> Glass Lewis, like other proxy advisors, obviously has an incentive to correct factual errors whenever it becomes aware of them and would do so whenever and however it learns of them. We focus here on the claims of “methodological weakness” that we suspect, based on our experience, will be the primary focus of the review periods.

<sup>84</sup> For example, the exemptive condition could be as concise as a requirement that proxy advisors “maintain policies and procedures that provide registrants (and certain other soliciting persons) a meaningful opportunity to comment on proxy advice and final notice of any proxy advice,” with Staff or Commission guidance filling in the timing and other elements.





critical to the workability of the resulting regime and we encourage the Commission to consider our suggestion that supplemental comment and/or a pilot program would be prudent given the scale and untested nature of the proposed requirements, as well as the importance of the continued, effective functioning of the proxy voting process to our corporate governance system.

### **3. The mandate to carry the issuer's hyperlinked response.**

We also have practical concerns about the mandate to publish a hyperlink to the issuer's response. Most importantly, this part of the rule should clearly indicate that the requested hyperlink must be "provided to" the proxy advisor before the end of the relevant period.<sup>85</sup> As proposed, the rule merely requires that the company has "requested" this by the deadline, which could be understood to allow a timely request to be made with the actual hyperlink to follow. This is not what the Commission seems to have intended,<sup>86</sup> and it would present serious difficulties in practice, including allowing a company to indefinitely delay adverse proxy advice.

We would also ask the Commission to reconsider the practicality of its expectations that the hyperlink would be "activated concurrently" with publication of the proxy advisor's report. While we understand that the Staff is trying to reconcile the proposal's unusual third-party publication mechanism with its existing rules on the filing of supplemental proxy materials, this sort of intricate coordination between the proxy advisor and company on a regular basis would be time-consuming, at best, and likely prone to error and delay. For issuers to avail themselves of this opportunity, they should provide the proxy advisor with an active, functional hyperlink within the two-day period, with no further obligation on the proxy advisor's part other than including the link in its proxy advice and electronic medium.

The proposed rule should also contain some reasonable guidelines and limitations on the communications that proxy advisors would be required to hyperlink to in their reports and

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<sup>85</sup> This part of the proposed rule's reference to "the period described in paragraph (b)(9)(ii)" is also ambiguous and conceivably could refer to any of three different periods of time. We assume what was intended here was the two business day period specified in paragraph (b)(9)(ii)(B). See Release at 55.

<sup>86</sup> See Release at 55 ("registrants would be required *to provide* the hyperlink (or other analogous electronic medium) to the proxy voting advice business no later than the expiration of the two-day final notice period that would be required under proposed Rule 14a-2(b)(9)(ii)(B)") (emphases added).



thereby transmit to their clients.<sup>87</sup> At a minimum, the response should: 1) be relevant to the matter at hand; 2) exclude any libelous or defamatory material; 3) exclude non-public information; and 4) exclude any unnecessary personal names or other personally-identifiable information. Also, as noted above, for basic reasons of fairness and efficiency, companies should not be allowed to use their response to present arguments (whether alleged factual errors or methodological weaknesses) that were not first presented to the proxy advisor during the initial review period or other earliest opportunity.

Much of this could be accomplished through a general proviso in the rule that the hyperlinked response is only available to companies that agree, in advance, to a proxy advisor's reasonable terms and conditions. (Issuers participating in Glass Lewis' Report Feedback Statement ("RFS") service<sup>88</sup> must agree to both terms and conditions and an etiquette guide.) Absent that, the Commission should include the points above in the rule and proxy advisors should also be allowed, as a condition of posting the hyperlink, to require the company to fully indemnify them for any loss or claim arising out of the content of the company's response or from distributing the hyperlink and its clients' subsequent use of the hyperlinked site.

The Release does say, "In our view, proxy voting advice businesses would not be liable for the content of the registrant's (or certain other soliciting person's) statement solely due to inclusion of a hyperlink (or other analogous electronic medium) to such a statement in their voting advice."<sup>89</sup> While we certainly agree that proxy advisors should not be liable for the mandated dissemination of third parties' statements, the only basis for this view cited in the Release is a Commission interpretation on companies' use of electronic media and the federal securities laws. The rule should include express liability protection for proxy advisors on this point, including preemption of any applicable state law (e.g., defamation). Absent that sort of meaningful protection, allowing proxy advisors to require reasonable terms and conditions, such as indemnification, becomes all the more important.

Finally, as noted above, it is important that the Commission clarify that changes to the proxy voting advice at this point in the process do not trigger new two-day notice periods. In particular, if the proxy advisor feels it necessary to respond in some way to a company's response (for example, to rebut what it sees as a false or misleading statement about its

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<sup>87</sup> Cf. Release at 65 Q. 38.

<sup>88</sup> Glass Lewis operates a service today where issuers can sign up to have their responses to proxy research reports transmitted to Glass Lewis clients. See <https://www.glasslewis.com/report-feedback-statement-service/>.

<sup>89</sup> Release at 65-66; see also Release at 55 n. 140.

advice), that should not restart a new final notice review period. If this were not made clear, the rule could lead to repeated cycles of responses and responses to responses.

## **E. Other Issues.**

### **1. Transition.**

We appreciate the Commission's recognition that there should be an appropriate transition period for proxy advisors to develop and implement the systems and processes that would be needed to comply with the proposed rules. We have two comments on the proposed period. First, in light of the pendency of litigation raising, at a minimum, significant issues about the statutory and constitutional bases for this rulemaking, we believe the appropriate course would be to delay the effectiveness of any final rules until these threshold legal issues are resolved by the courts. Absent that, proxy advisors may be required to begin to make substantial investments to develop the necessary systems while uncertain whether these systems will ultimately be needed. These costs, of course, could not be later recovered and may have to be passed on to proxy advisors' clients and, in turn, those clients' participants and beneficiaries. Second, given our expectations for what would be required to develop, implement and test the necessary systems and processes,<sup>90</sup> we believe an 18-month transition period after publication of the final rule in the Federal Register would be more appropriate. Also, given the intense seasonality of proxy advisors' work, the Commission should ensure that the transition period does not end during or shortly before the Spring proxy season and consider a phased implementation schedule.

### **2. Rule 14a-9 interpretation.**

The Commission also proposes to add four examples of how a proxy advisor's failure to disclose information could be a misleading statement under Rule 14a-9. Specifically, the rule would codify three examples briefly noted in the August 2019 Interpretation – "the proxy voting advice business's methodology, sources of information, [and] conflicts of interest." The rule would also add failure to disclose material information regarding "use of standards that materially differ from relevant standards or requirements that the Commission sets or approves" as another example of a misleading statement.

This is a significant change in the law, effectively requiring proxy advisors to make compliant disclosures or face SEC enforcement or private litigation. But, as to the first three — on methodology, sources of information and conflicts — the new rules are barely mentioned in the Release. The Release contains no discussion of the Commission's bases for adding these to

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<sup>90</sup> See note 138 below.



Rule 14a-9 or what would be required by the new rule text. Nor does the August 2019 Interpretation include any description of the Commission's basis for concluding that a lack of disclosure on these topics could be misleading or its expectations for non-misleading disclosure, beyond a few short and general footnotes.<sup>91</sup> Absent any such explanation, there will be significant, harmful uncertainty about the scope of Rule 14a-9 for proxy advisors, as well as unanswered questions about the implications of these interpretations for other parties that file proxy materials and face potential liability under Rule 14a-9 – and who, of course, have their own conflicts and use their own methodology and information sources. The Commission should withdraw this rule change or repropose it with a detailed description of what the Commission expects and its basis for adding these examples to its rules.

Likewise, while it does discuss the issue, the Release does not explain why an investor would have been misled by proxy advisors' past recommendations that were based on standards other than legal requirements. Specifically, the Release states, "clients may mistakenly infer that the negative voting recommendation is based on a registrant's failure to comply with the applicable Commission requirements when, in fact, the negative recommendation is based on the determination that the registrant did not satisfy the criteria used by the proxy voting advice business."<sup>92</sup>

Many of Glass Lewis' clients expect their portfolio companies to exceed minimum legal requirements (including Commission requirements) in some respects and Glass Lewis' house policy reflects that expectation. Also, as noted throughout this letter, vote recommendations issued by a proxy advisor may vary and mirror the custom policy selected by the client itself and many of Glass Lewis' clients' voting policies are also based on some standards that exceed minimum legal requirements. Given how common this is, the Commission's assumption that a client would be misled if a proxy advisor did not specifically point this out is unfounded and arbitrary. We believe compliance with Commission requirements is both the norm for public companies and reasonably expected by most parties involved in the proxy voting process; if a company were in violation of SEC requirements in some respect, that would likely warrant

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<sup>91</sup> See August 2019 Interpretation at 12-13. For example, there is no explanation of what the Commission expects to be disclosed about a proxy advisor's "methodology" for its advice to not be misleading, other than a footnote in the August 2019 Interpretation related to peer group construction. Glass Lewis makes its house voting policies publicly available, but the details of some aspects of its methodology are Glass Lewis' proprietary information and accordingly are not publicly disclosed.

<sup>92</sup> Release at 70.



specific mention in the proxy advice.<sup>93</sup> The Commission should withdraw this rule change or adequately explain how and why a shareholder would be misled by the common practice of evaluating companies against proxy advisors' and shareholders' own voting policies, rather than just compliance with law.

#### **IV. The economic analysis does not comply with the Commission's Current Guidance.**

To its credit, the Commission has made rigorous economic analysis a centerpiece of its rulemaking process. And, while economic analysis is always important, surely it is most vital in atypical rulemakings like this one, where the Commission is not implementing a statutory directive or making incremental changes to an existing rule, but is instead electing to use its discretionary rulemaking authority to intervene in the private market and take a service it has not regulated directly and subject it to a new and detailed regulatory regime.

Nor is this a rulemaking where the relevant data is outside the Commission's purview or the rule is intended to further a non-economic goal outside of the Commission's area of expertise. Proxy advisors' primary role is to review public companies' SEC filings and advise entities, many of whom are subject to SEC regulation, on how to vote on corporate governance matters. In fact, the SEC has previously used its examination authority to review in detail how investors use proxy advice in their voting. Countless public company letters and trade group-funded studies have been submitted to the SEC trying to make corporate managers' case for the Commission to regulate proxy advisors. As Commissioner Roisman emphasized at the Open Meeting, the Commission and Staff engaged in "extensive study" to put together its proposal on this issue that the SEC and others "have grappled with for well over a decade."<sup>94</sup>

It is all the more surprising then how little the economic analysis included in the Release says about why this new regulatory regime is needed and what its consequences would be from an economic perspective. In fact, the economic analysis included in the Release falls short of the Commission's responsibilities and its own standards on almost every count. No market failure is identified. No data or even information from the Commission's examinations was used to establish the baseline in practice. Reasonable alternatives — including ones

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<sup>93</sup> See Comments of the Pension Investment Association of Canada (Jan. 23, 2020) ("Any noncompliance with SEC rules should be a matter for SEC enforcement rather than a shareholder vote. It does not appear from our perspective that there is confusion as to whether proxy advisors are making recommendations based on legal non-compliance.").

<sup>94</sup> Statement of the Honorable Elad L. Roisman at SEC Open Meeting (Nov. 5, 2019), available at [https://www.sec.gov/news/public-statement/statement-roisman-2019-11-05-14a-2b#\\_ftnref4](https://www.sec.gov/news/public-statement/statement-roisman-2019-11-05-14a-2b#_ftnref4).

chosen by coordinate regulators and even raised by the SEC itself in its 2010 Concept Release — were ignored. No benefits or even costs are quantified, except for the burdens that had to be quantified for the PRA analysis. (And, as to those, Glass Lewis has already explained how they were vastly understated.) In fact, other than general market statistics, the only data in the economic analysis is a tabulation of issuer complaints in SEC filings, with no effort made to analyze whether those complaints were justified. The Release says little on the significant issue of competition, ignoring the concerns of other regulators. Nor does the analysis discuss or reconcile the proposed rules with the broader academic literature on the balance of power between management and shareholders in corporate governance. And the economic analysis sidesteps what may be the most significant economic consequence of the proposal, claiming that subjecting proxy advisors to potential litigation by companies was the result of an August 2019 Commission interpretation (with no economic analysis or public comment) and need not be economically analyzed now because the interpretation was already in place before this rule was proposed.<sup>95</sup>

#### **A. No market failure has been identified.**

The first, most basic principle of economic analysis of regulation is that the government should identify a market failure before intervening in the private market.<sup>96</sup> As a former SEC Chief Economist has explained, “the first element of [] an SEC . . . economic analysis is to identify the need for a rule. Often, this will involve a market failure.”<sup>97</sup> But the economic

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<sup>95</sup> We also note that the entire economic analysis ignores the implications of subjecting proxy advice to the information and filing requirements of the SEC’s proxy rules and only discusses the consequences of the new exemptive conditions. The economic analysis should consider all consequences of the new rules, however, which subject proxy advice to the information and filing requirements and add new exemptive conditions. See Glass Lewis’ PRA submission at 5-9. If the Commission considers proxy advisors’ compliance with the information and filing requirements impossible or so impractical as to not be worth analyzing, it should state that explicitly and explain why.

<sup>96</sup> See U.S. Securities and Exchange Commission RSFI and OGC, Current Guidance on Economic Analysis in SEC Rulemaking, at 4-5 (March 16, 2012) (“Current Guidance”).

<sup>97</sup> Speech of Mark Flannery, Director, Division of Economic and Risk Analysis, U.S. Securities and Exchange, “Economic Analysis: Providing Insight to Advance the Missions of the SEC and the PCAOB” (Oct. 22, 2015), available at <https://www.sec.gov/news/speech/keynote-address-pcaob-missions-of-sec-and-pcaob.html>; see also Exec. Order No. 12,866, sec. 1[b][1] (“each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new regulatory action) as well as assess the significance of that problem”).



analysis in the Proposing Release does not identify a market failure that provides the need for the rule. The term “market failure,” or recognizable variations of it, simply do not appear in the Release.<sup>98</sup>

This absence is particularly striking given that some of the Commission’s fellow regulators have studied the proxy advisor industry and concluded that there was no market failure. Most notably, ESMA, after an “extensive analysis” of proxy advisors, specifically said that it “found no evidence of a market failure requiring regulatory intervention.”<sup>99</sup>

Commentators have also made this point to the Commission. As one of the nation’s foremost corporate governance experts put it:

So, what we have is the most sophisticated institutional investors in the world, with access to the greatest resources for researching portfolio companies ever assembled, making a free market decision to pay for outside, objective analysis, no different from other securities analysis reports they may purchase, to help them better understand their holdings and better meet their obligation as fiduciaries for the people whose money they are investing to respond to corporate initiatives appropriately. There is no monopoly and no requirement to buy these services; they can buy from one, all, or none. There could not be a better example of market efficiency or a worse argument for government interference. And yet, here we are.<sup>100</sup>

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<sup>98</sup> The SEC’s Current Guidance on economic analysis in rulemaking further explains: “Traditional market failures include market power, externalities, principal-agent problems (such as economic conflicts of interest), and asymmetric information.” Again, however, the Release does not use these terms or clearly identify any of them as the market failure warranting this intervention. (While the Release does talk about proxy advisor conflicts, it does not identify these as a market failure warranting regulation, nor, as discussed below, could it make this case.)

<sup>99</sup> See Comments of Steven Maijoor, ESMA Chair, “ESMA recommends EU Code of Conduct for proxy advisor industry,” (Feb. 19, 2013), available at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-240.pdf>.

<sup>100</sup> See Nell Minow, “Regulating Proxy Advisors is Anticompetitive, Counterproductive, and Possibly Unconstitutional,” Harvard Corporate Governance Blog (Mar. 2, 2018), available at <https://corpgov.law.harvard.edu/2018/03/02/regulating-proxy-advisors-is-anticompetitive-counterproductive-and-possibly-unconstitutional/>; see also CII October 15 Letter at 2 (“[p]roxy advisory firms provide market-based solutions, and the SEC policy initiatives have the potential



Faced with this record, the Release does not grapple with these issues, let alone reach and provide a reasoned conclusion that there is a market failure or other need for this rule.

To be sure, there are passages in the Release on the importance of proxy voting and advice, as well as issuers' concerns about accuracy and conflicts. But even if proxy advisors' critics' claims were substantiated — which, as discussed above and below, they are not — this is not a sufficient basis to warrant government involvement under the SEC's economic analysis guidance. Many fields — law, management consulting, academia, journalism and countless others — are no less important and their practitioners sometimes make errors and face conflicts. What is missing from the analysis is a market failure — that is, the Release should explain why the market would not care about and address any accuracy or inadequate conflict disclosure issues over time. As a foreign regulator concluded after its own study: “[T]he overwhelming evidence supports the positive impact of proxy advisors. The criticisms of the workings are issues which can easily be resolved through market forces and are part of the evolution of both proxy advisors and investors.”<sup>101</sup>

In contrast, the types of economic conflicts warranting SEC regulation are structural issues that result in misaligned incentives. As a former SEC Chief Economist has explained:

For example, consider credit ratings agencies and audit firms . . . . [T]he *raison d'être* for credit rating and auditing firms has embedded within it a potential information problem of the sort they are intended to correct. Both types of agents are selected and paid by the affected firm, for the purpose of conveying information to third parties, i.e., investors. To whom do auditors and rating agencies ultimately owe their allegiance? Are their economic incentives consistent with this allegiance? Relevant policies in this area can seek to improve incentives without compromising the value of the services being provided.<sup>102</sup>

to adversely affect the voluntary, uncoerced, private contracts between investors and their proxy advisors”).

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<sup>101</sup> SEBI Working Group Report at 10.

<sup>102</sup> See Speech of Mark Flannery, Director, Division of Economic and Risk Analysis, U.S. Securities and Exchange, “Economic Analysis: Providing Insight to Advance the Missions of the SEC and the PCAOB” (Oct. 22, 2015), available at <https://www.sec.gov/news/speech/keynote-address-pcaob-missions-of-sec-and-pcaob.html>; see also Cezary Podkul, “SEC Urged to End Ratings Firms Conflicted Business Model,” Wall Street Journal (Nov. 4, 2019) (industry advisory group urging SEC to change payment model for CRAs to user-pays (i.e., the same as proxy advisors) in order to improve the reliability of ratings), available at

Here, however, there is no such conflict in the payment model or other structural misalignment of incentives. Proxy advisors are paid by the investors they advise.<sup>103</sup> Or, as CII put it, “Proxy advisors’ business model depends on factual accuracy and their incentives are thus aligned with issuers and institutional investors alike.”<sup>104</sup> The Commission should recognize, as other regulators have, that there is no market failure here and decline to intervene in this market.

#### **B. Evidence for claims of inaccuracy is lacking.**

As noted above, the Release references issuers’ “concerns” dozens of times. And foremost among those concerns are claims of proxy advisor inaccuracy. But SEC rules must be based on evidence, not just assertions.<sup>105</sup>

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<https://www.wsj.com/articles/sec-urged-to-end-ratings-firms-conflicted-business-model-11572911797>.

<sup>103</sup> See SEBI Working Group Report at 10 (“the level of conflict is substantially lower than other intermediaries like auditors and credit rating agencies, where the company being scrutinised is itself paying the intermediary”).

<sup>104</sup> CII October 15 Letter at 3. Apparently sensing this problem in the SEC’s economic analysis, an industry-funded group submitted a comment letter arguing, based on an academic study from 1982, that shareholders face a “collective action problem” in voting proxies. See Comments of Bernard Sharfman, Chairman, Advisory Council, Main Street Investors Coalition (Dec. 20, 2019). But, to the extent this is meant to provide the missing economic need for this rulemaking, there are at least two problems with it. First, there have been significant changes in the size and share of securities held by institutional investors over the last 40 years, greatly mitigating the issue discussed in the article. Second, SEC guidance says: “Frequently, the proposed rule will be a response to a market failure **that market participants cannot solve because of collective action problems.**” Current Guidance at 5 (emphasis added). Here, proxy advisors are a private market solution that helps address the collective action problem Sharfman describes (which exists much less today than 1982). This is not a logical reason to regulate proxy advice.

<sup>105</sup> See Current Guidance; see also Peirce and Ellig, 8 Brook. J. Corp. Fin. & Com. L. at 388 (criticizing SEC rulemaking for being “more willing than executive branch agencies to base decisions on beliefs or assertions rather than evidence”).

Here, that evidence is missing. To begin with, commenters have provided no logical explanation as to why proxy advice purchasers would not care if the advice was rife with errors. They do care and would be concerned if this was the case, which it is not. Both Glass Lewis and its largest competitor disclose an error rate of less than 1%. More to the point, commenters have not provided actual evidence of a concerning error rate. After all, whether proxy advisors commit frequent errors is an empirical question, but no empirical evidence has been provided to answer it.

The closest the economic analysis comes to providing evidence on this central issue is a table in the economic analysis that compiles situations in which a company filed supplemental proxy materials over a three-year period expressing various “concerns” about proxy advisors (“Table 2”). For four reasons, however, Table 2 does not provide a basis for the rules.

First, the SEC has not actually substantiated any of these concerns. The economic analysis only describes these as the views expressed in the company filing and we understand that the Staff have confirmed that they did not do any work to evaluate whether these claims were valid or baseless. This begs the question why Table 2 was included in the Release. Proxy advisors are hired to critically evaluate management recommendations, and they do sometimes recommend against these recommendations. It is therefore not particularly notable or significant that some companies — 264 of a possible 17,296 in the SEC’s sample<sup>106</sup> — expressed some sort of continued disagreement or concern about proxy advice.

Second, commenters cannot evaluate and provide meaningful comments on Table 2 because the SEC has not provided basic details about the analysis it summarizes. Seeking comment on a proposed economic analysis is only meaningful if the SEC provides enough detail for commenters to understand and react to the Commission’s analyses.<sup>107</sup> To that end, another former SEC Chief Economist has explained that “[o]ur goal is to be transparent about our methodologies, assumptions, and data sets and we hope that commentators will provide rigorous feedback on our analyses.”<sup>108</sup> But, here, the SEC has not been transparent. Despite repeated requests and explanations of why these details are needed, the Staff have not

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<sup>106</sup> Based on our count of the reclassified information in the DERA supplemental memo.

<sup>107</sup> See Portland Cement Association v. Ruckelshaus, 486 F.2d 375, 394 (D.C. Cir. 1973) (“It is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that, [to a] critical degree, is known only to the agency.”).

<sup>108</sup> See Speech of Craig M. Lewis, Director, Division of Economic and Risk Analysis, U.S. Securities and Exchange, “The Expanded Role of Economists in SEC Rulemaking,” (Oct. 16, 2012), available at <https://www.sec.gov/news/speech/2012-spch101612cmlhtm>.

divulged basic information about their analysis — most notably, which companies they categorized as expressing concern about factual errors. This has frustrated commenters’ ability to evaluate whether these were or were not factual errors, a central issue in this rulemaking.<sup>109</sup>

Third, the SEC has not adequately explained why it included the categories it did, particularly “Amended or modified proposal.” The Release describes this category as situations where the “registrant responds to a current or prior year negative recommendation from a proxy voting advice business by indicating that it has amended or modified proposals or existing governance practices prior to the annual meeting and requests investor consideration of these facts in making their vote.”<sup>110</sup> To be fair, the SEC did only describe this as a “registrant concern.” But, by classifying it with factual errors and other registrant concerns, the economic analysis suggests the SEC sees it as a problem the proposal would address. Other regulators have considered the adoption of corporate governance best practices to avoid adverse proxy advisor recommendations a positive development: “Boards are therefore ensuring support of shareholders when endeavouring to meet the parameters within proxy advisers’ recommendations. This is appropriate and aligns the interests of the shareholders with the board and management of their companies, which are sometimes not fully aligned.”<sup>111</sup> If the SEC has a different view and sees a company adopting such a practice as akin to a factual error, it should explain that view and support its contention with evidence of the harm resulting from these situations.<sup>112</sup>

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<sup>109</sup> While the DERA staff did add a memorandum to the file towards the end of the comment period, after a FOIA request and multiple other letters and in-person requests, that memorandum does not include basic information like which companies claimed factual errors or were included in the SEC’s other categories.

<sup>110</sup> Release at 96 n. 239.

<sup>111</sup> SEBI Working Group Report at 17; see also *id.* at 9 (“In fact, some of the benefits of proxy advisors may be invisible, as people would have altered their actions to escape the critical analysis of proxy advisors. So, a person sitting on too many boards may opt to give up her board seat by withdrawing from the slate of directors up for election. In other words the impact of possible proxy advisor’s recommendation would have altered behaviour even though no one will notice the impact.”).

<sup>112</sup> Similarly, the supplemental DERA memo states that the Staff included in its sample of “concerns” situations in which the “registrant identified changes of circumstance that should warrant reconsideration of an adverse voting recommendation.” Again, this does happen, but we are not clear why the Staff would categorize it as a concern or how it provides a basis for this new regulatory regime.

Fourth and finally, Table 2 shows at most that 54 of 17,296 or .3% of company filings over this time period claimed a factual error and 260 or 1.5% contained a more general “concern,” broadly defined, with some aspect of some proxy advisors’ proxy advice.<sup>113</sup> The Release suggests there may be some other companies that believed there was an error or had other concerns with proxy advice during this time period, but did not say anything.<sup>114</sup> At the same time, it is likely that some of these claimed errors or concerns were exaggerated or just unfounded. Glass Lewis has long disclosed that its error rate is less than 1%. Nothing in Table 2 gives any reason to believe errors are more frequent than that.

In short, the economic analysis lacks empirical evidence on the empirical question at the foundation of the proposed rules. The Commission should answer this empirical question before imposing a costly, untested, new regulatory regime premised on concerns about proxy advisor accuracy.

### **C. The economic analysis fails to understand the baseline.**

As the SEC Staff’s Current Guidance recognizes, the second element of a good economic analysis is understanding the baseline, which is “the best assessment of how the world would look in the absence of the proposed action.”<sup>115</sup> As a SEC Chief Economist explained:

A baseline . . . is vital to understand how a market is functioning before we can identify what might be wrong within it. This goes beyond a simple recitation of current

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<sup>113</sup> Based on Table 2 data since the additions and reclassifications in the DERA supplemental memorandum are not classified. We note that both these rates are for all proxy advisors. The rate for any individual proxy advisor would be lower.

<sup>114</sup> There is no reason to think this would be a significant number. As the IAC notes, company management can use the company’s resources and has strong incentives to bring any material proxy advice errors to their shareholders’ attention. Recommendation of the SEC Investor Advisory Committee (IAC) Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals at n. 21 (Jan. 24, 2020) (“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.”).

<sup>115</sup> Current Guidance at 6.

regulatory requirements or an overview of general market statistics. It is incumbent upon regulators to understand fully the complexities of the markets we regulate. Only then can we make a theoretical market failure concrete and specific.<sup>116</sup>

Here, however, the economic analysis does little beyond reciting some general market statistics. Even though accuracy appears to be the Commission's primary concern, the economic analysis, as noted above, does not even claim to evaluate whether that is a problem. Nor does it contain any original information about proxy advisor conflict policies and conflict disclosures, instead just noting, based on letters, that "some proxy voting advice businesses have disclosure practices and procedures regarding conflicts of interest that may be similar to these proposed disclosure requirements,"<sup>117</sup> without further discussing what those practices are or what may be wrong with them.<sup>118</sup> Nor did the SEC use any original information on the timing of companies' filing of proxy statements or when investment advisers typically vote, critical start and end points for evaluating the effect of the proposed rules on the timing of proxy advice and voting.

Here, the failure to provide evidence of actual market practices is all the more surprising because the SEC conducted focus examinations of proxy advisors and investment advisers' use of proxy advisors in 2015.<sup>119</sup> While the resulting examination reports are not available to the public, GAO reported in November 2016 that "SEC staff also considered some of the issues discussed previously [i.e., accuracy, conflicts disclosure, "over-reliance" on proxy advisors] through examinations of proxy advisory firms registered as investment advisers and registered investment companies using proxy advisory firms."<sup>120</sup> GAO further explained that, while the

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<sup>116</sup> Speech of Mark Flannery, Director, Division of Economic and Risk Analysis, U.S. Securities and Exchange, "Economic Analysis: Providing Insight to Advance the Missions of the SEC and the PCAOB" (Oct. 22, 2015), available at <https://www.sec.gov/news/speech/keynote-address-pcaob-missions-of-sec-and-pcaob.html>.

<sup>117</sup> Release at 92.

<sup>118</sup> The Release does cross-reference an earlier footnote that notes that "there is no uniform set of standards" for conflicts mitigation and that "concerns remain about the adequacy of these firms' conflicts of interest disclosures." This obviously falls far short of a full understanding of current market practices and why and how they need to be improved.

<sup>119</sup> See Office of Compliance Inspections and Examinations, National Examination Priorities for 2015 at 4, available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf>.

<sup>120</sup> GAO 2106 Report at 35.

2015 proxy advisor priority examinations were ongoing, GAO reviewed 41% of them completed as of August 2016 and “confirmed that the SEC examined risk areas related to conflict of interest, proxy voting policies and procedures, and oversight of proxy advisory services, among other issues. None of the examinations we reviewed resulted in serious violations leading to an enforcement action.”<sup>121</sup>

The SEC should use its direct evidence from these examinations to understand the baseline-in-practice and evaluate for itself both the concerns precipitating this rulemaking and the proposed rules’ potential consequences.<sup>122</sup> Information collected in examinations could provide actual evidence on issuers’ claims of inaccuracy and lack of adequate conflict disclosure. It also would give the SEC a factual basis to understand the consequences of the regulatory approach chosen, including its effect on the timing of a complex, time-sensitive process. If the SEC somehow has no relevant data from its 2015 or other examinations, it should state so and explain why and how it could nonetheless reach a sufficient, reasoned understanding of the market practices of proxy advisers and investment advisers’ proxy voting.

The SEC also failed to adequately consider the regulatory baseline. First, the economic analysis’ discussion of the regulatory baseline does not mention the SEC’s recent expansion of investment advisers’ responsibilities to oversee proxy advisors. As discussed above, however, in guidance issued just this past August, the SEC addressed a number of the issues in this rulemaking, including proxy advisors’ conflicts policies, engagement with issuers and accuracy. The SEC conveyed its expectation that investment advisers would review their oversight of proxy advisors in response to this guidance and commentators agreed that it would lead to changes for both proxy advisors and investment advisers.<sup>123</sup>

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<sup>121</sup> Id. at 36 (footnote omitted). GAO’s report indicated that SEC Staff reviewed and provided technical comments on the report before it was issued.

<sup>122</sup> See Marc Wyatt, Director, Office of Compliance Inspections and Examinations, “Inside the National Exam Program in 2016” (Oct. 17, 2016) (“As the SEC’s “eyes and ears” in the field, OCIE strives to use our perspective to provide support to the rule-making process and inform other guidance issued by the SEC, and its Divisions and Offices. . . . Based on our exams, we provide our rule-writing colleagues information about the evolution of market practices and the most common exam observations.”), available at <https://www.sec.gov/news/speech/inside-the-national-exam-program-in-2016.html>. Of course, the SEC can also ask for other information it needs to understand the need for or potential consequences of a rule and also has other authority to obtain such information. See, for example, 15 U.S.C. 77s(e).

<sup>123</sup> See The Conference Board, “On Governance: What Does the Latest SEC Guidance Mean for Proxy Advisors, Companies?,” (Aug. 26, 2019) (“It looks like both the [proxy] advisors and their



Nor does the economic analysis — or any other part of the Release, for that matter — mention the Best Practices Principles for Shareholder Voting Research instituted in response to ESMA’s consultation. As noted above, the Best Practices Principles focus on identifying, disclosing and managing conflicts of interest and fostering transparency to ensure the accuracy and reliability of proxy advice, the same concerns at issue here. And signatory proxy advisors apply and measure themselves against these principles on a global basis annually.

The baseline, of course, “includes both the economic attributes of the relevant market and the existing regulatory structure.”<sup>124</sup> But the baseline — and the economic analysis as a whole — does not discuss either the August 2019 Guidance or the Best Practices Principles, let alone consider them adequately to show that it “understand[s] fully” the regulatory baseline. The SEC should not institute a significant new regulatory regime without first considering and understanding the effect of existing regulatory measures that address the same issues.

#### **D. The economic analysis fails to consider reasonable alternative approaches.**

As the Current Guidance explains, the Commission is required to consider reasonable alternative regulatory approaches, including “reasonable alternatives raised during the rulemaking.”<sup>125</sup> To his credit, Chairman Clayton told the Senate Banking Committee when he testified on December 10, 2019 about this proposed rulemaking that he was “very open” to alternative ways to promote proxy advisor accuracy.

This is not reflected in the economic analysis, however. While six “reasonable alternatives” are mentioned, the first four are variations on the chosen regulatory approach — issuer pre-review, mandated publication of the issuer’s response and prescribed conflicts

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clients will need to adopt and implement some new policies and procedures, and that in some cases existing policies and procedures will need to be modified and/or documented.”) (quoting Robert Lamm, Esq.), available at <https://www.conference-board.org/blog/environmental-social-governance/SEC-Addressing-Proxy-Advisor-Influence>.

<sup>124</sup> Current Guidance at 7.

<sup>125</sup> Current Guidance at 9 (citing the D.C. Circuit decision in *Chamber I*); see also Speech of Craig M. Lewis, Director, Division of Economic and Risk Analysis, U.S. Securities and Exchange, “The Expanded Role of Economists in SEC Rulemaking,” (Oct. 16, 2012) (“when the Commission adopts a rule, the rule release must articulate why the Commission chose the alternative it did, fully engaging with those reasonable alternatives raised in the proposing release or suggested by commentators”), available at <https://www.sec.gov/news/speech/2012-spch101612cmlhtm>

disclosure. While the details of the proposed rules need to be explored in other parts of the Release, we do not believe this is what the Current Guidance meant in saying that the Commission should consider “alternative regulatory approaches.” The fifth alternative discussed is a tangentially-related concern of companies about shareholders voting before reading company responses. The last “alternative” — exempting smaller proxy advisors — is already covered in the Release’s mandatory regulatory flexibility analysis. Notably, none of the alternatives included in the Release even contemplates the possibility proxy advisor accuracy could be enhanced in some way other than government-mandated issuer pre-review.<sup>126</sup>

In reality, there are a number of genuine “alternative regulatory approaches” that the Commission should consider. In fact, the SEC itself has previously raised other alternatives to address these issues.

In its 2010 Concept Release on the Proxy Process, after noting issuers’ concerns with proxy advisors, the Commission specifically sought comment on:

whether proxy advisory firms operate the kind of national business or have an impact on the securities markets that Advisers Act Section 203A(c) was designed to address, and whether, as a result, we should establish an additional exemption from the prohibition on federal registration for proxy advisory firms to register with the Commission as investment advisers.<sup>127</sup>

The Concept Release then discussed how guidance could be used in that framework to enhance conflict of interest disclosures.

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<sup>126</sup> As the IAC has noted, with one exception, the alternatives are all more burdensome on proxy advisors and their clients. See Recommendation of the SEC Investor Advisory Committee (IAC) Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals, at 8 (Jan. 24, 2020). Tellingly, the SEC does not consider an alternative of mandating that issuers file their proxy statements sufficiently early to avoid the compression of investor time the proposal would create. For example, the SEC should have considered an alternative of mandating that companies either file proxy statements a sufficient number of weeks before their annual meeting (or just adjusting the thresholds for review and feedback period eligibility enough), so as to allow investors the same time they have today to consider proxy advice and vote. The SEC should then have assessed the costs and benefits of that approach relative to the proposal.

<sup>127</sup> 2010 Concept Release at 120 (citation omitted).

Likewise, the Concept Release discussed “potential approaches that might address concerns about accuracy or transparency in the formulation of voting recommendations,” and specifically suggested that “proxy advisory firms could provide increased disclosure regarding the extent of research involved with a particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring the accuracy of issuer data.”<sup>128</sup> The Concept Release further noted a suggestion that the Commission’s NRSRO rules “may be useful templates for developing a regulatory program addressing conflicts of interest and other issues with respect to the accuracy and transparency of voting recommendations provided by proxy advisory firms.”<sup>129</sup> The Commission here noted that the NRSRO regulatory regime includes measures such as disclosure of performance measurement statistics.<sup>130</sup> Both of these alternatives should have been considered in the economic analysis.<sup>131</sup>

In addition, there are at least two other reasonable alternatives, in addition to the status quo, that should have been fully explored. First, as Glass Lewis has previously suggested,<sup>132</sup> the Commission should have considered a market-based approach that builds on the existing, industry-developed Best Practices Principles. In fact, ESMA chose this very approach. Adding a regulatory compliance, reporting or assurance mechanism to the current Best Practices Principles could add rigor and ensure consistency, while still preserving the benefits of this approach.

Critically, these alternatives would provide a more complete and balanced framework to advance the Commission’s stated goal of improving proxy advisor accuracy. After all, the issuer review and feedback periods at best only address accuracy from the company’s point of view — a one-sided approach that will not address any other type of factual error. In fact, there is no reason to think companies would even bother to review for accuracy roughly half of proxy

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<sup>128</sup> 2010 Concept Release at 122.

<sup>129</sup> *Id.* at 121 n. 287

<sup>130</sup> *Id.*

<sup>131</sup> See, for example, Chamber of Commerce of the United States v. Securities and Exchange Commission, 412 F.3d 133, 144 (D.C. Cir. 2005) (“Chamber I”) (finding an APA violation when the Commission chose a mandate as an exemptive condition and did not consider a suggested disclosure alternative).

<sup>132</sup> See Letter of Katherine Rabin, Chief Executive Officer, Glass Lewis to Chairman Jay Clayton (Nov. 14, 2018), available at <https://www.sec.gov/comments/4-725/4725-4649188-176490.pdf>.

research reports, which typically do not contain any recommendation adverse to management's recommendations, meaning there would not even be a potential for accuracy improvement in those situations. At the same time, the delays associated with the issuer review periods would greatly compress the time for investor due diligence before voting. If the Commission determines it has a sufficient basis to regulate proxy advisors to enhance the accuracy of their work and elects to do so through issuer review and feedback, it should explain why choosing a regulatory approach that only affects one dimension of accuracy is a better alternative than more holistic approaches.

Second, if the Commission felt only an issuer-review mandate could address its concerns about accuracy, it should have considered having issuers review just the facts that would go into the proxy advice. In fact, this would be more consistent with the approach chosen in the context of analyst regulation, where, with appropriate safeguards, analysts are permitted to verify facts with the companies that are the subject of their reports, but are prohibited from sharing their full reports.<sup>133</sup> As noted above, Glass Lewis has a current practice of sharing the key facts in its reports, free of charge, with all U.S. companies through its IDR. Glass Lewis finds that through this practice it can get any benefit of company review without compromising the independence of its advice or inviting time-consuming and unproductive debates about Glass Lewis' methodology or what result that methodology should lead to in the context of a particular recommendation. This approach would also have been consistent with the Commission's prior recognition that, on most corporate governance questions, there "typically is not a correct viewpoint."

#### **E. The economic analysis fails to quantify any costs or benefits.**

The economic analysis does not quantify any costs or benefits of the proposed rule. Nor does it make any of the underlying estimates that would be essential to understanding the costs and potential benefits of the proposed rules, such as the number of reviews that would be required, the time they would take, the number of conflicts that would be disclosed, and projections of decreased errors. In fact, other than some general market statistics, the only effort at quantifying anything in the economic analysis is the table showing the number of issuer complaints about proxy advice discussed above.<sup>134</sup>

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<sup>133</sup> See the discussion of FINRA Rule 2241 above.

<sup>134</sup> While the Release's PRA analysis does, as required, make some estimates of paperwork burdens, these are incomplete and vastly understated, as explained in Glass Lewis' PRA Submission.



This does not meet the Commission’s standards for economic analysis. As the Current Guidance explains, the economic analysis should “quantify [the] expected benefits and costs to the extent possible . . . and [] for those elements that are not quantified, explain why they cannot be quantified.”<sup>135</sup> Courts have imposed similar obligations. When, as here, data is available, the Commission must estimate and quantify the costs it expects parties to incur.<sup>136</sup>

When the Commission first explicitly exempted proxy advice, it acknowledged that forcing parties to comply with proxy solicitation rules was “very costly.”<sup>137</sup> And, as illustrated in Glass Lewis’ PRA Submission,<sup>138</sup> just the paperwork burdens of the exemptive conditions on proxy advisors — a subset of the direct costs imposed by the proposed rules — would be substantial. Other direct costs and indirect costs — such as the opportunity costs discussed above and the effect on competition discussed below<sup>139</sup> — should also be considered and estimated to the extent possible.

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<sup>135</sup> Current Guidance at 9-10.

<sup>136</sup> Business Roundtable v. Securities and Exchange Commission, 647 F.3d 1144, 1150 (D.C. Cir. 2011).

<sup>137</sup> SEC Shareholder Communications Release at 49,278.

<sup>138</sup> See PRA Submission at 10-20. Subsequent to our PRA Submission, we have made further efforts to estimate the first-year costs of developing and deploying the customized software that we think would be needed to efficiently carry out the two-stage issuer reviews contemplated in the proposed rules. Glass Lewis does not, of course, have existing systems that would be sufficient to track the time periods and manage the necessary workflows to carry out the review processes in the proposed rules. Cf. Release at 106. Our estimate at this point is that it would take six people twelve months to build such a platform. That level of effort translates to about 13,000 development hours. At \$100/hour, we expect this would require approximately \$1.25M in development costs. If such a system could be developed and deployed, that could affect some of our other time estimates for some of the ongoing administrative tasks that would be involved in carrying out the rules.

<sup>139</sup> The Current Guidance also notes that costs include “negative collateral consequences, such as the potential misuse of newly created rights.” Current Guidance at 11. This issue, which as noted above is implicated here, is not considered in the economic analysis.

The Commission should make the necessary estimates, quantify the costs and benefits of its proposed rules to the extent possible, and seek supplemental comment on its revised analysis.<sup>140</sup>

**F. The economic analysis fails to seriously consider the effect on competition.**

The Commission, of course, has an explicit statutory requirement to consider the effect on competition in its rulemaking under the Exchange Act. Here, that obligation should have special resonance given the long-standing questions about competition in this space.

Despite this, the Proposing Release’s effect on competition analysis consists of two pages, a significant part of which is devoted to speculating — contrary to the evidence before the agency of proxy advisors’ customers’ actual views — that the proposed rules might increase demand and stimulate competition because the advice will be more accurate and conflicts more apparent. A revised economic analysis should give this issue serious consideration and account for two significant items in the administrative record.

First, this is the unusual case where the Commission has actual, first-hand evidence that the rule would adversely affect competition. Minerva Analytics, a UK-based proxy advisor, has commented that the prospect of the proposed rules being adopted has, in fact, deterred it from entering the U.S. proxy advisor market:

The proposed rules will not, as argued by the pro-regulation lobby, enhance competition; they will kill it outright. For as much as Minerva would like to make a formal entry into the US market with a local presence, the implicit threat of expensive and burdensome litigation as proposed by the regulations for “errors” together with the mandating of free and prior distribution of our research at the expense of our clients’ contractual rights renders that possibility highly unlikely for the foreseeable future.<sup>141</sup>

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<sup>140</sup> The Commission should also consider the significance of the costs and benefits it cannot quantify. Much of the Commission’s economic analysis reads like its drafter sought to pair each very real and substantial cost it acknowledges with a countervailing benefit, however speculative, abstract or minor, such as the “benefit” of “more clear notice” that rules apply to certain conduct. And the paired costs and benefits are often followed with a statement that the Commission cannot quantify either, leaving a false sense of equivalence. A meaningful economic analysis would genuinely and candidly assess and convey the significance of the qualitative costs and benefits it discusses, even if they cannot be quantified.

<sup>141</sup> Comments of Sarah Wilson, Chief Executive Officer, Minerva Analytics (Jan. 2, 2020).



Second, over 60 prominent finance and legal scholars, with a range of ideological perspectives, have submitted a comment letter expressing concern about the anti-competitive effect of the proposed rules. The letter states:

We share the Commission’s concerns about concentration in the proxy advisory market. Yet, we disagree with the following proposed remedies: 1) forcing proxy advisors to share their opinions with managers ahead of time and 2) treating opinions on proxies as proxy solicitations. By increasing the cost of opining on proxy statements such proposals will only discourage new entry into the proxy advisory market and exacerbate the problem of market concentration in this sector. We ask the Commission to strike these proposed changes.<sup>142</sup>

The Commission should take this direct evidence and strong academic consensus into account and engage in a serious consideration of the effect of the proposed rules on proxy advisor competition.<sup>143</sup>

The Commission should also consider the effect of the proposed rules on competition among asset managers. As the Release recognizes, in order to save costs, many asset managers choose to outsource much of the data collection, research tasks and other administrative functions associated with proxy voting to proxy advisors.<sup>144</sup> As one commentator explained, proxy advisors “economize the proxy research and voting functions by spreading the costs of tracking, analyzing, and processing many thousands of proxy votes over a larger pool of shareholders.”<sup>145</sup> And, as the Release also notes, smaller asset managers are more dependent

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<sup>142</sup> See Comments of Anat Admati, Luigi Zingales et al. (Jan. 15, 2020).

<sup>143</sup> In addition to its broader obligation to consider the economic implications of its rules, the Commission is specifically required to consider the impact that any rule promulgated under the Exchange Act would have on competition and to include in the rule’s statement of basis and purpose “the reasons for the Commission’s . . . determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of [the Exchange Act].” Exchange Act Section 23(a)(2), 15 U.S.C. 78w(a)(2).

<sup>144</sup> Release at 79-80.

<sup>145</sup> Cappucci, *The Proxy War Against Proxy Advisors* at 7; see also *id.* at 7-8 (“If asset managers or owners had to perform these functions themselves, they would face an unattractive choice between bearing the costs of additional staff to perform the research and not adding resources and being less informed and less responsible voters.”).



on outsourcing these functions to proxy advisors than the largest asset managers.<sup>146</sup> Accordingly, a reduction in competition and/or increase in costs of proxy advice could disproportionately affect smaller asset managers.<sup>147</sup> The Release does not consider this effect on competition, however. Particularly in light of the trend toward asset manager concentration, the Commission should consider the potential effect of the rules on the asset management industry.

**G. The economic analysis fails to consider any effects of exposing proxy advisors to private litigation by issuers.**

As Commissioner Jackson recognized at the Open Meeting, “[T]he real costs of today’s new regime lie in considering the issuer’s feedback, including the issuer’s response in the proxy advisor’s report, and facing litigation from an issuer angry about the methodology used to provide anti-management advice.”<sup>148</sup> But this prospect of issuer litigation against proxy advisors is not even mentioned in the economic analysis. Instead, the Release explains, “Overall, we do not expect this proposed amendment [amending the definition of solicitation in the Commission’s rules to include proxy advice] to have a significant economic impact because it codifies an already-existing Commission interpretation.” In fact, the only mention of litigation in the entire release is a question. After noting CII’s concern about subjecting proxy advisors to increased litigation through the August 2019 Interpretation, the Release asks: “Would these concerns similarly apply to aspects of the proposed amendments, or is this concern overstated in that the aspects of the interpretation and guidance that are encompassed in the proposed amendments reflect current legal obligations regarding solicitation activities?”

In other words, the Commission is disclaiming any responsibility to assess the costs and benefits and other economic consequences of exposing proxy advisors to the unprecedented prospect of litigation by companies displeased with their advice. This is because the proposed rules would codify the August 2019 Interpretation that proxy advisors are subject to this litigation threat — an interpretation adopted 3-2 over the dissent of a Commissioner who said it should have been the subject of public comment and economic analysis. Through this two-

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<sup>146</sup> Release at 80.

<sup>147</sup> If smaller managers more frequently chose not to vote, that could also have adverse consequences for our system of corporate governance that the Commission should consider.

<sup>148</sup> Statement of the Honorable Robert J. Jackson, Jr. at SEC Open Meeting (Nov. 5, 2019), available at <https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-openmeeting>.

step process,<sup>149</sup> the Commission could end up with a rule on its books exposing an industry to a new type of private litigation without ever having to follow its “statutory obligation to determine as best it can the economic implications of the rule.”<sup>150</sup>

Establishing this precedent would allow an easy end run around the National Securities Markets Improvement Act considerations in similar circumstances, in the future. In fact, by the Release’s logic, an interpretation imposing exorbitant costs could be issued the day before a rule proposal with no economic analysis and then the rule proposal issued the next day could simply say the rules have no costs because the rules would only codify the interpretation. We do not believe this is good administrative practice or consistent with the Commission’s responsibilities.

Here, the Commission is engaged in rulemaking that would result in an Exchange Act rule exposing proxy advisors to Rule 14a-9 litigation. To our knowledge, the Commission has never previously examined the costs, benefits and other economic consequences of doing so and it has the opportunity to do so as part of this rulemaking.<sup>151</sup> And this is not some technical defect in process; the prospect of issuer litigation poses very real and significant risks and costs to proxy advisors that should be analyzed and considered. If these costs are outweighed by the benefits, in the Commission’s view, the economic analysis should explain how and why the Commission came to that conclusion.

#### **H. The economic analysis fails to engage with broader literature on executive compensation and corporate governance.**

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<sup>149</sup> When the Commission adopted the August 2019 Interpretation, the Chairman described it as “just a first step,” and disclosed that he had “asked the staff to also consider whether the current rule definition of the term ‘solicitation’ under the federal proxy rules should be amended to codify today’s interpretation.” See Statement of the Honorable Jay Clayton at Open Meeting (Aug. 21, 2019), available at <https://www.sec.gov/news/public-statement/statement-clayton-082119>.

<sup>150</sup> Chamber I, 412 F.3d at 143.

<sup>151</sup> See also Motion of the U.S. Securities and Exchange Commission, at 3-4 in *ISS v. Clayton*, Case No. 1:19-cv-3275-APM (D.D.C. Jan. 17, 2020) (“Because the challenged Interpretation and Guidance has been incorporated into the rulemaking, **the rulemaking will enable ISS to raise any of its objections to the Interpretation and Guidance during the rulemaking process, and it will afford the Commission an opportunity to consider those objections.** If the Commission adopts the proposed amendments after notice and comment, this Court would have the benefit of a more robust administrative record.”) (emphasis added).

Finally, the economic analysis should have considered the effect the proposed rule could have on corporate governance and executive compensation practices and reconciled the Commission's proposal with the broader academic literature on these points.<sup>152</sup> As Commissioner Jackson noted at the Open Meeting, "Proxy advisors play an important role in striking the right balance in allocating power between corporate executives and investors."<sup>153</sup> And, as he also noted, there is a well-established body of legal and economic scholarship examining that issue that was not considered in the Proposing Release. Given the implications of the proposed rules for the balance of power between management and shareholders, the Commission should have considered this literature and reconciled its policy choices with it.<sup>154</sup>

For example, the Commission's Chief Economist has argued that investors need to be more skeptical than they are today about executive pay recommendations. Writing in the Harvard Business Review, then-Professor S.P. Kothari and Robert Pozen explain that: "More than 95% of the time, shareholders overwhelmingly approve the pay recommendations. Yet our research suggests that investors should be more skeptical. Compensation committees frequently adjust company performance numbers in complex and even obscure ways, for a variety of reasons." Although he notes the challenges they face in doing so, Kothari concludes

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<sup>152</sup> The economic analysis does contain an overview of some of the academic literature specifically on proxy advisors. See Release at 81-83. Our point here is that the analysis did not engage with the broader economic literature the proposed rules implicate, especially in light of the scope of some of its analysis. See, for example, Release at 113 (arguing, with no reference to the literature, that investors may make better voting decisions, thereby leading to better investing outcomes and promoting capital formation).

<sup>153</sup> Statement of the Honorable Robert J. Jackson, Jr. at SEC Open Meeting (Nov. 5, 2019) ("Taxing anti-management advice in this way makes it easier for insiders to run public companies in a way that favors their own private interests over those of ordinary investors."), available at <https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-openmeeting>.

<sup>154</sup> See Peirce and Ellig, 8 Brook. J. Corp. Fin. & Com. L. at 400 (criticizing the say on pay rulemaking mandated by Dodd-Frank: "the SEC could have taken advantage of a large literature on executive compensation and corporate governance. Among other things, academics have looked extensively at issues related to agency problems and asymmetric information in the governance of publicly held corporations. The SEC would have had to look at this literature in the context of its existing mandates, including extensive compensation disclosure requirements.") (footnote omitted).

that, among other things, investors should engage in “meaningful dialogue” with companies about “overly generous compensation” practices. The proposed rules, by shortening the time an investor has to vote, would drastically limit the investor’s ability to engage with a company on a compensation issue, if required. Yet the Commission’s Release does not mention this article or reconcile its approach with the costs to shareholders of compressing their review and voting time and the resulting risk of inadequate oversight of management compensation practices.

## **V. The proposed rules have fundamental legal flaws.**

### **A. Proxy advice is not a proxy solicitation.**

Absent a legislative framework for proxy advisor regulation, the Commission proposes to regulate proxy advisors as proxy solicitors. As we understand it, the sole statutory term providing the foundation for the new proxy advisor regulatory framework is the verb “solicit” in Section 14(a) of the Exchange Act. Proxy solicitation is fundamentally different than proxy advice, however; the simple, unavoidable fact is that solicit and advise mean two different things.

To “solicit” means to “[a]sk for or try to obtain (something) from someone.”<sup>155</sup> Here, that something is a proxy — i.e., the authority to vote on that party’s behalf in a corporate election. Consistent with this, there are two fundamental characteristics of proxy solicitors’ work that makes it a solicitation:

- 1) Proxy solicitors ask for or try to obtain proxy authority from shareholders; and
- 2) Proxy solicitors have an interest in the outcome (or are hired by someone with an interest in the outcome) and therefore play an advocacy role to “try to obtain” shareholders’ proxy authority.

In contrast, proxy advisors do not meet either of these two characteristics of a solicitation. Proxy advisors do not ask for or try to obtain proxy authority from their shareholder clients. And proxy advisors have no stake in the outcome. They are simply hired by the shareholder to provide them with objective research and advice as a disinterested party.

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<sup>155</sup> Lexico, Oxford University Press (2019); see also Oxford English Dictionary (2020) (“To entreat or petition (a person) for, or to do, something”; “To request, petition, or sue for (some thing, favour, etc.); to desire or seek by petition”; “Of things: To call or ask for, to demand”).

The SEC’s approach depends on conflating these two, quite different roles. In fact, the interpretation blurs the fundamental distinction in this process — between the side campaigning for an outcome on the vote and the side actually voting. Proxy solicitors are the ones asking for votes and shareholders, with the assistance of their proxy advisor agents, are the ones voting.

This common sense difference in meanings is reflected in industry practice. Proxy solicitors and proxy advisors have long been understood to have separate roles, indeed separate industries. When the SEC itself described the players in the proxy landscape in its 2010 Concept Release, its background included one section on “proxy solicitors” and another on “proxy advisory firms.”<sup>156</sup> And the fundamental difference between these two activities is reflected in the reaction of knowledgeable industry participants, who have reacted with surprise and concern to the SEC’s efforts to conflate the two.<sup>157</sup>

The SEC’s new interpretation also does not fit with the overall statutory scheme of the Exchange Act’s regulation of the proxy voting process. The “words of the statute should be read in context, the statute’s place in the overall statutory scheme should be considered, and the problem Congress sought to solve should be taken into account to determine whether

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<sup>156</sup> See 2010 Concept Release at 23-25 (explaining, in part, that “Issuers sometimes hire third-party proxy solicitors to identify beneficial owners holding large amounts of the issuers’ securities and to telephone shareholders to encourage them to vote their proxies consistent with the recommendations of management.”).

<sup>157</sup> See Comments of Dana Investment Advisers Letter (Dec. 5, 2019) (“The characterization of proxy-voting advice provided by proxy-advisory firms as “solicitation” is blatantly false and demonstrates a grave misinterpretation (or misrepresentation) of the process.”); Comments of Theresa Whitmarsh, State of Washington Investment Board (Jan. 22, 2020) (“WSIB’s proxy advisors are providing guidance, data, tracking and timely execution of our voting on proxy resolutions. Our advisors are NOT soliciting us to vote in support of particular policies or in a particular direction.”); see also Nell Minow, Comment on Ted Allen, “A ‘Draft Review’ as a Safeguard on Proxy Advisors,” Harvard Law School Corporate Governance Blog (May 18, 2019) (“The reference to proxy solicitation rules is so inapposite as to be absurd. The proxy solicitation rules are a safeguard against the advocacy of parties with a clear incentive to provide only one side of the story on matters that are fundamental to a company’s continuing operations and structure. Proxy advisors are independent third parties who sell a product no one has to buy with recommendations no one has to follow.”), available at <https://corpgov.law.harvard.edu/2019/05/18/roundtable-on-proxy-voting-process/>.

Congress has foreclosed the agency's interpretation.”<sup>158</sup> Here, the SEC’s proposed construction does not fit with the statute’s scheme or its purpose. The federal securities laws’ proxy solicitation information and public filing requirements are wholly unsuited to proxy advice. Where solicitors want their communications to be public — because they are soliciting proxy authority, after all — proxy advisors only provide their research and advice to their paying clients.<sup>159</sup> And, unlike soliciting parties, proxy advisors produce thousands of proxy research reports a year. In fact, the Proposing Release implicitly concedes this by not even discussing the possibility that proxy advisors would seek to comply with the information and filing requirements for proxy solicitations.<sup>160</sup> And the statute’s underlying purpose — deterring the deceptive speech self-interested “[i]nsiders” had used to defraud investors in proxy campaigns<sup>161</sup> — is irrelevant to disinterested proxy advice.

In defense of its new interpretation, the SEC invokes its prior “broad” interpretations of the statute, particularly an amendment to its rules in 1956 that provided a catch-all in the SEC’s definition of solicitation. The August 2019 Interpretation puts a broad gloss on this broad catch-all, expansively reading it to cover “any person seeking to influence the voting of proxies

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<sup>158</sup> Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006) (quoting PDK Labs. Inc. v. DEA, 362 F.3d 786, 796 (D.C.Cir. 2004)) (internal quotation marks omitted); see also Abbott Labs. v. Young, 920 F.2d 984, 988 (D.C.Cir. 1990) (“The ‘reasonableness’ of an agency’s construction depends on the construction’s ‘fit’ with the statutory language as well as its conformity to statutory purposes.”).

<sup>159</sup> See the longer discussion of this at pages 5-10 of our PRA Submission.

<sup>160</sup> The Release does assert: “We further believe that the regulatory framework of Section 14(a) and the Commission’s proxy rules, with their focus on the information received by shareholders as part of the voting process, is well-suited to enhancing the quality and availability of the information that clients of proxy voting advice businesses are likely to consider as part of their voting determinations.” Release at 17-18. This statement is not explained, however, and it is hard to reconcile with the reality of those requirements or the fact that the possibility of proxy advisors complying with them is not otherwise discussed in the Release.

<sup>161</sup> See H.R. Rep. No. 1383, 73d Cong., 2d Sess., at 14 (Apr. 27, 1934) (“Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights . . . . For this reason the proposed bill gives the Federal Trade Commission power to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders.”).

by shareholders, regardless of whether the person itself is seeking authorization to act as a proxy.”<sup>162</sup>

There are at least two problems with this, though. First, the SEC has previously recognized that its catch-all definition was “sweeping” and “excessive” — potentially covering, among other things, newspaper op-eds and legal advice. As the SEC put it in 1992, “the [1956] definition of solicitation was so great as potentially to turn almost every expression of opinion concerning a publicly-traded corporation into a regulated proxy solicitation.”<sup>163</sup> In fact, the SEC called this overbreadth a “distortion of the purposes of the proxy rules.”<sup>164</sup> None of this is mentioned in the Proposing Release or August 2019 Interpretation, however. Instead, the SEC now has not only embraced that “sweeping” and “excessive” definition, but actually proposes to expand it through its new interpretation and a specific rule provision covering proxy advice.

Second, even if the overbroad definition in the SEC’s rules were a valid reading of the Exchange Act, properly read, it would not cover proxy advice. The SEC’s catch-all in the rules covers a “communication to security holders under circumstances *reasonably calculated to* result in the procurement, withholding or revocation of a proxy” (emphasis added). But, as unmoored as this is from the statutory phrase “solicit any proxy,” even this broad formulation includes an element of intent to achieve an outcome that is absent with proxy advice. “Calculated” means “planned or contrived to accomplish a purpose.”<sup>165</sup> And “procurement” is “the act or process of procuring,” which, in turn, is defined as “to get possession of

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<sup>162</sup> See August 2019 Interpretation at 5. In the wake of the August 2019 Interpretation, some of the Commissioners have started referring to the “proxy solicitation umbrella.” See, for example, Statement of the Honorable Hester M. Peirce at the Open Meeting (Nov. 5, 2019) (“proxy voting advice falls under the proxy solicitation umbrella”), available at <https://www.sec.gov/news/public-statement/statement-peirce-2019-11-05-proxy-voting-advice>.

<sup>163</sup> SEC Shareholder Communications Release at 48,278; see also *id.* at 48,279 (“As a result of [the 1956] definition, almost any statement of views could be alleged to be a solicitation”).

<sup>164</sup> While the SEC addressed this problem by exempting these types of communications from the information and filing requirements, rather than creating a more reasonable regulatory definition, its action had the effect of eliminating any practical effect of its overbroad definition on most groups of persons that otherwise would have been covered by it. The proposed rules would undo those exemptions for proxy advisors.

<sup>165</sup> Merriam-Webster Dictionary (2019); see also American Heritage Dictionary (5<sup>th</sup> ed. 2018) (“Made or planned to accomplish a certain purpose”).



(something): to obtain (something) by particular care and effort.”<sup>166</sup> In contrast, a proxy advisor is a disinterested third-party who is not planning or contriving to achieve any outcome and who is not trying to obtain any shareholder’s proxy authority. Proxy advisors simply assist their shareholder clients through research and advice (as well as the mechanical casting of votes) — essentially an outsourced version of what a sufficiently large institutional investor would ask its own staff to do.<sup>167</sup>

In short, the SEC interpretation ignores the distinction between an advocate with its own interest trying to achieve an outcome — with the attendant risks Congress saw in that sort of speech — and a disinterested third party providing advice. Both might “influence” the shareholders’ vote, as the August 2019 Guidance strains to redefine the issue.<sup>168</sup> But at that level of generality, any number of disparate types of communications might be covered. In a court, both a counsel’s argument and a law clerk’s legal research might “influence” the judge’s decision, but that in no way makes the two roles equivalent.

If this reading were not clear on its face — and it is — basic principles of statutory construction would compel it. Courts construe statutes narrowly, rather than broadly and flexibly, when an expansive reading would either: 1) raise a serious constitutional issue; or 2) expand the scope of an implied private right of action. Here, the SEC’s proposed interpretation would do both.

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<sup>166</sup> Merriam-Webster Dictionary (2019).

<sup>167</sup> Just because proxy advisors at times act as shareholders’ agents in administrative parts of the proxy voting process does not make them “proxy solicitors.” State corporate law clearly recognizes a distinction between granting a proxy to a party and a shareholder authorizing an agent to act on its behalf in a voting matter, such as granting that proxy. See DEL Code 8-212(c)(1) (“A stockholder may execute a writing authorizing another person or persons to act for such stockholder as proxy. Execution may be accomplished by the stockholder or such stockholder’s authorized officer, director, employee **or agent** signing such writing or causing such person’s signature to be affixed to such writing by any reasonable means including, but not limited to, by facsimile signature.”) (emphasis added).

<sup>168</sup> Nor do the new, historical definitions of “solicit” brought forth in the Release help this argument. Release at 19 n. 48. These, too, include an element of intent to achieve an outcome, with the exception of the outlier “[t]o take charge or care of, as business.” But this meaning does not make sense in the statutory context “solicit” is used and, taken literally, would seem to turn any business related to the proxy process, such as a print shop or vote counter, into a proxy solicitor. In any event, we note that the Oxford English Dictionary (1933) describes this meaning of the term as “obsolete.”

First, as further discussed below, the SEC has already acknowledged that interpreting the statute as broadly as it now proposes to do would raise “serious questions under the free speech clause of the First Amendment.” Courts construe statutes to avoid such issues, not to invite them.<sup>169</sup>

Second, the SEC’s interpretation would expand an implied private right of action. In fact, the SEC’s initial reason for making this new interpretation was to do just that,<sup>170</sup> thereby subjecting proxy advisors to this implied cause of action. As the Supreme Court has said in the context of reviewing a prior SEC interpretation, “[c]oncerns with the judicial creation of a private cause of action caution against its expansion.” Accordingly, the Court said, in reviewing

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<sup>169</sup> See Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 348 (1936) (“When the validity of an act of the Congress is drawn in question, and even if a serious doubt of constitutionality is raised, it is a cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided.”) (Brandeis, J. concurring). Reading the statute in this broad a manner would also create a serious constitutional problem under the non-delegation doctrine, since there is no intelligible principle in the Exchange Act for how to regulate proxy advisors. Proxy advisors are not mentioned in the Exchange Act. Instead, purporting to use its exemptive authority, the SEC proposes to create an entirely new regulatory scheme of its own design for proxy advisors — similar to ones Congress considered, but did not enact into law. In doing so, the SEC would be making all the major policy decisions — beginning with whether to regulate proxy advisors down to every detail of the review periods — on its own with no Congressional direction or guidance beyond a general “necessary or appropriate in the public interest” standard and consistent with the protection of investors’ standard. This is a far cry from a situation where an agency is being asked to “fill up the details” or address a “statutory gap.” See Gundy v. United States, 588 U.S. \_\_\_\_ (2019) (Gorsuch, J. dissenting) (reviewing the history of the non-delegation doctrine); see also *id.* (Alito, J. concurring) (indicating support for revisiting the Court’s approach to nondelegation questions). For this reason also, the statute should not be read in such a broad manner as to invite this problem. See Utility Air Regulatory Group v. EPA, 573 U.S. 302 (2014) (“When an agency claims to discover in a long-extant statute an unheralded power to regulate a significant portion of the American economy, we typically greet its announcement with a measure of skepticism.”) (internal citation and quotations omitted).

<sup>170</sup> See August 2019 Interpretation at 11 (“Does Exchange Act Rule 14a-9 apply to proxy voting advice? **Response:** Yes.”).

the SEC’s interpretation, “we are mindful that we must give narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute . . . .”<sup>171</sup>

The SEC has previously acknowledged that what it called a literal reading of the solicitation definition in its rules would be “sweeping” and “excessive.”<sup>172</sup> But now the SEC seeks to expand that “sweeping” and “excessive” definition even further, to explicitly cover proxy advisors. But no amount of breadth and flexibility can turn the term “solicit” into “advise.”<sup>173</sup> The interpretation at the foundation of this rulemaking is simply not consistent with the statute.

## **B. The proposed rules violate the First Amendment.**

The issuer review and feedback and compelled access mechanisms — which, as far as we know, have no precedent in other contexts of securities regulation — also violate the First Amendment.

### **1. Requiring government or issuer review.**

The SEC itself has recognized the First Amendment implications of its broad definition of solicitation. The SEC’s “solution” to this in 1992 was to create multiple exemptions that cover that speech and therefore keep it outside the regulatory scheme for proxy solicitations. As the SEC said 28 years ago when it exempted proxy advice and other types of shareholder communications from the notice and filing requirements of the proxy rules:

A regulatory scheme that inserted the Commission staff and corporate management into every exchange and conversation among shareholders, their advisors and other parties on matters subject to a vote certainly would raise serious questions under the free speech clause of the First Amendment, particularly where no proxy authority is being solicited by such persons. This is especially true where such intrusion is not necessary to achieve the goals of the federal securities laws.

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<sup>171</sup> See Janus Capital Group v. First Derivative Traders, 564 U.S. 135 (2011) (internal quotations and citations omitted).

<sup>172</sup> SEC Shareholder Communications Release at 48,277-78.

<sup>173</sup> Goldstein, 451 F.3d at 882 (“That the Commission wanted a hook on which to hang more comprehensive regulation of hedge funds may be understandable. But the Commission may not accomplish its objective by a manipulation of meaning.”).



The purposes of the proxy rules themselves are better served by promoting free discussion, debate and learning among shareholders and interested persons, than by placing restraints on that process to ensure that management has the ability to address every point raised in the exchange of views.<sup>174</sup>

Now, though, the SEC proposes to add onerous conditions to those exemptions for a particular type of speaker whose speech some market participants do not like. As previously discussed, the proposed rules would force proxy advisors to submit their research and advice to issuers for their prior review and feedback before they can publish it to their clients in order to avoid having to comply with a government filing requirement that is wholly impractical and incompatible with their business model.

As the Supreme Court has explained, “Any system of prior restraints of expression . . . bear[s] a heavy presumption against its constitutional validity.”<sup>175</sup> The “Government thus carries a heavy burden of showing justification for the imposition of such a restraint.”<sup>176</sup> The proposed rules’ effective mandate that proxy advisors clear their reports with issuers amounts to a prior restraint on speech and there is nothing close to such a justification here.<sup>177</sup>

Even if not analyzed as a prior restraint, the proposed rules would chill proxy advisors’ speech in a manner incompatible with the First Amendment. The First Amendment prevents the government from imposing overbroad measures that discriminate based on the content of the speech or tilt the marketplace of ideas in favor of a preferred view or party. Here, by deputizing one group (corporate management) to review and police the speech of another group (proxy advisors), the proposed rules would single out a type of speech and skew the marketplace of ideas in favor of a preferred group’s preferred speech. Of all the types of solicitations the SEC purports to regulate, only proxy advisors are covered by the proposed

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<sup>174</sup> SEC Shareholder Communications Release at 48,279.

<sup>175</sup> New York Times v. United States, 403 U.S. 713, 714 (1971).

<sup>176</sup> *Id.*

<sup>177</sup> Following the approach of this proposal, the SEC could attach similar exemptive conditions to other things it has found to be “solicitations,” such as newspaper op-eds or legal advice. For example, the SEC could mandate that newspaper opinion pieces that might influence a proxy vote first be reviewed by the company involved before being published. Few would deny that such a requirement would be antithetical to the First Amendment, but that is the regime the SEC proposes here for proxy advice.

rules. And only the soliciting party — corporate management in the vast majority of cases — gets to review and provide feedback on proxy advisors' speech.<sup>178</sup> Accordingly, the rules only work to complicate and deter recommendations expressing one type of view — an anti-management recommendation.<sup>179</sup> In fact, the Proposing Release even raises the concept of only requiring review when the proxy advisor's opinion is anti-management, but then dismisses that idea — not because it is incompatible with the rule's intended purposes — but for practical reasons.<sup>180</sup> Thus, the proposed rules are content-based and viewpoint-based restrictions on speech.<sup>181</sup> Content-based restrictions "are presumptively unconstitutional and may be justified only if the government proves that they are narrowly tailored to serve compelling state interests."<sup>182</sup> Here, for all the reasons discussed above, the proposed rules cannot survive strict scrutiny; they are far from narrowly tailored to serve compelling state interests.<sup>183</sup>

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<sup>178</sup> This viewpoint bias is reflected in the decision to not afford pre-review rights to shareholder proponents.

<sup>179</sup> As the IAC Recommendation explains: "If [the rules were adopted], 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."

<sup>180</sup> Release at 45 n. 112.

<sup>181</sup> Reed v. Town of Gilbert, 576 U.S. \_\_\_ (2015) ("Government regulation of speech is content based if a law applies to particular speech because of the topic discussed or the idea or message expressed."); *id.* ("Our precedents have also recognized a separate and additional category of laws that, though facially content neutral, will be considered content-based regulations of speech: laws that cannot be " 'justified without reference to the content of the regulated speech,' " or that were adopted by the government "because of disagreement with the message [the speech] conveys").

<sup>182</sup> *Id.*

<sup>183</sup> See Richard A. Kirby and Beth-ann Roth, "A Step Too Far: The SEC's Attempt to Regulate Proxy Advisory Services Violates the First Amendment," at 5 (Jan. 2020) ("Demanding disclosure of methodology and making proxy advisory firms give prior notice of the content of their advice is perhaps the most intrusive rather than the least intrusive alternative that could have been

Nor does the “commercial speech” doctrine apply here. Just because speech is on a commercial topic does not make it commercial speech.<sup>184</sup> Instead, as the Supreme Court has repeatedly explained, commercial speech is “speech which does no more than propose a commercial transaction.”<sup>185</sup> That is plainly not what is at issue here. Likewise, “professional speech” is not entitled to lesser First Amendment protection. The “Court has not recognized ‘professional speech’ as a separate category of speech. Speech is not unprotected merely because it is uttered by ‘professionals.’”<sup>186</sup>

As the SEC recognized in 1992, the type of speech at issue here — proxy advisors’ disinterested research and advice on matters of fact and opinion about important corporate governance matters at public companies — is entitled to First Amendment protection. Content-based restrictions on such speech, like those that would be imposed here, are presumptively unconstitutional and must be narrowly tailored to serve compelling state interests. Here, the overbroad and unnecessarily intrusive measures in the proposed rules cannot withstand any level of First Amendment scrutiny, much less the strict scrutiny they are subject to under longstanding Supreme Court precedent.

## **2. The mandate to publish the issuer’s rebuttal.**

The proposed rules’ requirement that proxy advisors publish the company’s reply to its report in the form of a hyperlink also violates the First Amendment. As the Supreme Court held in unanimously striking down a state “right of reply” statute that granted a political candidate a

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chosen by the Commission.”). For similar reasons, the SEC’s extension of Rule 14a-9 to cover “opinions” and “beliefs” and proposed promulgation of multiple interpretations of that rule directed toward proxy advisors also amounts to a content-based and viewpoint-based regulation of speech that violates the First Amendment.

<sup>184</sup> Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of New York, 447 U.S. 557, 571 (1980); Virginia State Board of Pharmacy, 425 U.S. 748 (1976).

<sup>185</sup> Virginia State Board of Pharmacy at 762 (internal quotations and citation omitted).

<sup>186</sup> Nat’l Inst. of Family and Life Advocates v. Becerra, 578 U.S. \_\_\_ (2018). As the Supreme Court held in a different case involving an investment advice and research publication, “To the extent that the chart service contains factual information about past transactions and market trends, and the newsletters contain commentary on general market conditions, there can be no doubt about the protected character of the communications.” Lowe v. SEC, 472 U.S. 181, 210 (1985).

right to equal space to answer criticism in a newspaper, “any such a compulsion to publish that which reason tells [the publisher] should not be published is unconstitutional.”<sup>187</sup> In fact, the Supreme Court has applied this principle in a case with circumstances remarkably similar to those presented here and found, for three separate reasons, that the state action violated the First Amendment.

In Pacific Gas & Electric v. Public Utility Commission,<sup>188</sup> a state agency permitted a public interest group to use “extra space” in a utility’s billing envelope to convey its own messages, including criticism of the utility, so long as there was a disclaimer making it clear those were not the utility’s views. As here, the state agency reasoned that access to multiple viewpoints would benefit ratepayers:

Our goal . . . is to change the present system to one which uses the extra space more efficiently for the ratepayers' benefit. It is reasonable to assume that the ratepayers will benefit more from exposure to a variety of views than they will from only that of PG&E.<sup>189</sup>

The Court, however, had no trouble concluding that this “compelled access” violated the First Amendment. First, the Court found that it infringed the utility’s First Amendment rights by forcing it “to help disseminate hostile views.” As the Court noted, the utility “might well conclude” that, under these circumstances, “the safe course is to avoid controversy, thereby reducing the free flow of information and ideas that the First Amendment seeks to promote.”<sup>190</sup>

Second, the law also abridged the First Amendment because it required the utility –  
  
to assist in disseminating [the public interest group’s] views; it does not equally constrain both sides of the debate about utility regulation. This kind of favoritism goes well beyond the fundamentally content-neutral subsidies that we sustained in [*Buckley and Regan*]. Unlike these permissible government subsidies of speech, the Commission's order identifies a favored speaker “based on the identity of the interests

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<sup>187</sup> Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241, 256 (1974) (internal quotations omitted).

<sup>188</sup> 475 U.S. 1 (1986).

<sup>189</sup> *Id.* at 6.

<sup>190</sup> *Id.* at 14.



that [the speaker] may represent," . . . and forces the speaker's opponent — not the taxpaying public — to assist in disseminating the speaker's message. Such a requirement necessarily burdens the expression of the disfavored speaker.<sup>191</sup>

Third, the Court found that the law “impermissibly requires [the utility] to associate with speech with which [the utility] may disagree.” Since the public interest group can discuss any issue, the utility may be forced to either appear to agree or respond:

Especially since [the public interest group] has been given access in part to create a multiplicity of views in the envelopes, there can be little doubt that [the utility] will feel compelled to respond to arguments and allegations made by [the public interest group] in its messages to [the utility’s] customers. That kind of forced response is antithetical to the free discussion that the First Amendment seeks to foster.<sup>192</sup>

Each of the reasons the Court gave for striking down the state order in PG&E applies here. Proxy advisors would be “forced to help disseminate hostile views,” which might have a chilling effect on their speech to begin with. Second, as in PG&E, the compelled access is only available to one specific actor — the soliciting party, who in the vast majority of cases will be corporate management. A shareholder or employee of the company cannot have its views distributed through the proxy advisor’s report, and neither can an investor group that agrees with the proxy advisor recommendation or one that thinks a proxy advisor should not have recommended in favor of a management proposal. Third, it requires proxy advisors to associate with speech they might disagree with, which, in turn, might compel them to use their space, time and resources to respond to views that they disagree with.

For all the same reasons identified by the Court in PG&E, this is content-based, compelled access of the sort that violates the First Amendment.<sup>193</sup>

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<sup>191</sup> Id. at 14-15.

<sup>192</sup> Id. at 16.

<sup>193</sup> Nor does it somehow make a difference for constitutional purposes that the rule requires the proxy advisor to publish a hyperlink, rather than the entire text of the issuer’s reply, in its report. The speech-altering and chilling effects the Court identified as infringing the First Amendment in PG&E apply to the hyperlink, no less than they did to the slip of paper at issue there.

**C. The SEC’s reliance on dubious “comment letters” has corrupted the notice and comment process.**

The rulemaking is also tainted by the Commission’s reliance on apparently fraudulent evidence. The Commission’s Proposing Release — the vehicle for conveying the substance and basis for the SEC’s proposal in order to facilitate public comment — relied on evidence that has been shown to be suspect and potentially fraudulent. Specifically, the Proposing Release states that “representatives of the registrant and retail investor communities have expressed concerns about the oversight and accountability over proxy voting advice businesses.” Cited as support for this statement are several letters purportedly from retail investors. These letters, however, have had their authenticity called into question and they and others are reportedly now the subject of an SEC Inspector General investigation. For example, this statement in the Proposing Release cites the views of Pauline Yee, whose two-page letter explains that she is a retired teacher with concerns about the effect of proxy advisors on her pension. As Bloomberg News later reported, however: “That retired teacher? Pauline Yee said she never wrote a letter, although the signature was hers.”<sup>194</sup>

Most importantly, this is not just any another statement in the Release. A majority of the Commissioners who voted to propose the rules have indicated that the point made in this statement was central to their support for the initiative. Most notably, at the Open Meeting where these rules were proposed, Chairman Clayton gave remarks summarizing the proposed rules, explaining their basis and encouraging public comment. In doing so, the Chairman explained his rationale, after receiving extensive, conflicting input in connection with the Commission’s Proxy Roundtable, for proceeding to regulate proxy advisors:

Some of the letters that struck me the most came from long-term Main Street investors, including an Army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single Mom, a couple of retirees who saved for retirement, all of whom expressed concerns about the current proxy process. A common theme in their letters was the concern that their financial investments — including their retirement funds — were being steered by third parties to promote individual agendas, rather than to further their primary goals of being able to have enough money to lessen the fear of “running out” in retirement or to leave money to their children and grandchildren. These letters are a helpful reminder that the issues the Commission grapples with in this

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<sup>194</sup> See Zachary Mider and Ben Elgin, “SEC Chairman Cites Fishy Letters in Support of Policy Change,” Bloomberg News (Nov. 19, 2019) (“Bloomberg I”).

area are not a matter of (1) shareholders versus companies or (2) businesses that provide proxy voting advice versus companies. These are false dichotomies.<sup>195</sup>

Likewise, in supporting the related August 2019 Interpretation and Guidance, Commissioner Roisman rejected institutional investors' supportive views about proxy advisors, noting that, in contrast, retail investors had expressed concerns about proxy advisors in letters that he "encourage[d] everyone to look at."<sup>196</sup> All seven letters cited by the Chairman, as well as the letters cited by Commissioner Roisman, were apparently produced as part of an effort to deceive the Commission that is now under investigation.

In the wake of the disturbing revelations about the apparent fraud at the heart of this rulemaking, however, the Commission took no action to preserve the integrity of the notice and comment process. Although the Bloomberg article came out in mid-November 2019, several weeks before the Proposing Release appeared in the Federal Register and despite being asked

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<sup>195</sup> Statement of the Honorable Jay Clayton at SEC Open Meeting (Nov. 5, 2019) (footnotes omitted), available at [https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting#\\_ftn13](https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting#_ftn13).

<sup>196</sup> See Statement of the Honorable Elad L. Roisman at SEC Open Meeting (Aug. 21, 2019), available at <https://www.sec.gov/news/public-statement/statement-roisman-082119> ("I have heard the warnings that any action, regulation, or oversight that directly or indirectly constrains proxy advisory firms will be viewed by some as a gift to the management and directors of public companies, resulting in harm to investors. For example, I have heard that the Commission should not take any action related to proxy voting advice provided by proxy advisory firms because "...the investors themselves...the ones paying for proxy advice...are not asking for protection." To be clear, in this context, I do not consider asset managers to be the "investors" that the SEC is charged to protect. Rather, **the investors that I believe today's recommendations aim to protect are the ultimate retail investors**, who may have their life savings invested in our stock markets. These Main Street investors who invest their money in funds are the ones who will benefit from (or bear the cost of) these advisers' voting decisions. In essence, I believe it is our job as regulators to help ensure that such advisers vote proxies in a manner consistent with their fiduciary obligations and that the proxy voting advice upon which they rely is complete and based on accurate information. **I encourage everyone to look at the public comments received in connection with the Staff Roundtable on the Proxy Process last year. We have heard not only from hundreds of public companies, but from investor groups and individual investors. These commenters have expressed varying concerns relating to the influence that proxy advisory firms appear to have over proxy voting decisions in our markets.**") (footnotes omitted). In making these comments, Commissioner Roisman cited the same retail investor comment letters as the Proposing Release.

to “repair the rulemaking record,”<sup>197</sup> the Commission did not amend its release to remove the suspect information. Nor did the SEC revise or annotate the Chairman’s Open Meeting statement, or, to our knowledge, take any other action that would lessen the risk of commenters also being deceived by the misinformation.<sup>198</sup>

Predictably, commenters picked up on the misinformation they had been encouraged to look at and commented assuming the genuineness of those statements. For example, on December 6, 2019, Ken Blackwell wrote a comment letter quoting at length from the part of Chairman Clayton’s Open Meeting remarks on individual investor support for the proposal and exclaiming, “*This is the issue . . . I completely agree with the Chairman.*”<sup>199</sup> In fact, Mr. Blackwell quoted from the “couple of retirees” highlighted by the Chairman, even though, as the SEC knew by this point, when contacted by Bloomberg the purported author of that letter had said, “I never wrote a letter. . . . What’s this all about?”

Nor was the harm limited to just an isolated comment letter. Others also relied on this dubious information.<sup>200</sup> And Mr. Blackwell seems to have raised enough concern with others that they, too, wrote in support of the SEC’s rule.<sup>201</sup> In fact, the corruption of the comment process has spread beyond this original batch of dubious letters and the misunderstandings that stemmed from their promotion. Perhaps emboldened by the success of this initial effort, a significant percentage of the unique comment letters filed to date show signs of having been orchestrated by organizations that conduct “astroturf” campaigns and were presumably paid to

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<sup>197</sup> Better Markets Press Release, “The SEC and Justice Department Should Investigate Allegations That Fraudulent Comment Letters Were Submitted in Support of Recent Rule Proposals Favoring Vested Corporate Interests,” (Dec. 9, 2019), available at <https://bettermarkets.com/newsroom/sec-and-justice-department-should-investigate-allegations-fraudulent-comment-letters-were>

<sup>198</sup> In fact, in response to the Bloomberg article, a SEC spokesperson dismissed the issue, saying “[t]he various letters we received on the proxy process highlighted the importance of these issues. We welcome all interested parties, particularly our Main Street investors, to comment on our proposals.” Bloomberg L.

<sup>199</sup> Comments of Ken Blackwell (Dec. 6, 2019) (emphasis in original).

<sup>200</sup> See also Comments of Benjamin Zycher, Ph.D. (Jan 17, 2020) (quoting Chairman Clayton’s statements at the Open Meeting about the concerns of these “Main Street investors”).

<sup>201</sup> See, for example, Comments of Nathan Martin (Dec. 30, 2019) (“I had read something from Ken Blackwell which alerted me that the SEC was considering this rule to regulate proxy advisors.”).

generate support for the rules.<sup>202</sup> The result has been a further corruption and politicization of the SEC’s notice-and-comment process for this rulemaking.

Under the Administrative Procedure Act, an agency engaged in informal rulemaking must provide interested persons a reasonable and meaningful opportunity to participate in the rulemaking process.<sup>203</sup> And, for there to be such a meaningful opportunity, the agency must provide adequate notice of what the agency is proposing to do **and its basis** for doing so.<sup>204</sup> This principle has obvious implications for the unusual situation presented here — when an agency learns before the comment period even starts that part of the basis for its proposal, especially the part its Chairman said was particularly significant to his thinking about the rule, was likely fabricated. But the Commission took no action to amend its Proposing Release or otherwise alert commenters to the misinformation it had highlighted. By not doing so, commenters could be, and in fact were, misled by the same false information. Other individual commenters perhaps did not weigh in at all, having been told that a number of their fellow retail investors were concerned about proxy advisors and that this disproved that this was an issue of corporate versus shareholder interests. Either way, the result of not correcting this misinformation was to deprive the public of a meaningful opportunity to comment on the rules based on genuine, non-fraudulent information.<sup>205</sup>

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<sup>202</sup> See Andrew Ramonas and Andrea Vittorio, “SEC Proxy-Firm Rules Spur YouTube Call to Stop ‘Liberal Agenda’,” Bloomberg Law (Jan. 17, 2020) (describing efforts of groups to spread misinformation that proxy advisors are supporting “liberal causes” like abortion and “sanctuary cities” to generate SEC comment letters supporting proxy advisor regulation).

<sup>203</sup> See Forester v. CPSC, 559 F.2d 774 (D.C. Cir. 1977); United Steelworkers v. Marshall, 647 F.32d 1189 (D.C. Cir. 1980).

<sup>204</sup> See Portland Cement Association v. Ruckelshaus, 486 F.2d 375, 394 (D.C. Cir. 1973) (“In order that rule-making proceedings to determine standards be conducted in orderly fashion, information should generally be disclosed as to the basis of a proposed rule at the time of issuance.”).

<sup>205</sup> See Howard Fischer, “INSIGHT: Fact and Fantasy in SEC Rules—The Battle Over Proxy Contests Relies on Imaginary Soldiers,” Bloomberg Law (Jan. 13, 2020) (“Fischer”) (“While these are not yet approved rules, simply proposals, the claimed reliance on the letters has infected the rule-making process. The letters represent not merely statements of fact, but reflect statements about what ordinary investors want and believe—statements that have proven to be false.”), available at <https://news.bloomberglaw.com/securities-law/insight-fact-and-fantasy-in-sec-rules-the-battle-over-proxy-contests-relies-on-imaginary-soldiers>.

To be sure, mass and fake comment letters are becoming an issue in agency rulemakings across the government.<sup>206</sup> Here, however, the issue is different and more significant than just trying to keep fake emails out of the comment file. In this case, the problematic information was relied upon by the SEC as a pivotal part of the basis for the proposed rules and, through individual Commissioner’s statements, was actually highlighted as a specific and important point about their basis for supporting the rule and who would benefit from it. In these circumstances, providing a meaningful comment period required correcting the record.

Related but separate from the legal considerations at issue here, we would encourage the Commission to consider the potential ramifications of these events for its rulemaking processes and the public’s faith in those processes. The SEC has a deserved reputation for the quality of its administrative practices and the non-partisan nature of its work. At a minimum, what happened here has harmed the integrity of this rulemaking — which, after all, is intended to address issues of accuracy, transparency and disclosure of conflicts — as well as public perceptions of the rulemaking’s integrity and fairness.<sup>207</sup>

Perhaps even more concerning, though, are its future implications. The unfortunate effect of not correcting the rulemaking record and just proceeding to rule adoption would be to reward the misconduct of those who deceived the Commissioners and thereby tainted the administrative record. And, if successful here, the purveyors of this misinformation and others like them will only be encouraged, risking this sort of deception becoming a regular feature of SEC rulemakings. In addition to the obvious harms of this, it could also cause the agency and others to question the authenticity of actual individual investors who take the time and make the effort to write in with their genuine comments. These would be grave harms to the Commission’s processes and we encourage the Commission to take strong remedial measures to avoid them, including repairing the rulemaking record in this proceeding and inviting additional comment on a basis that does not include fabricated letters.

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<sup>206</sup> See, for example, Administrative Conference of the United States, Forum on Mass and Fake Comments in Agency Rulemaking (Oct. 15, 2018).

<sup>207</sup> See Fischer (the Commission’s reliance on these letters “undermines the integrity of the rule-making process”).



## Conclusion.

For all the reasons stated above, Glass Lewis respectfully requests that the Commission not adopt the proposed rules and, instead, continue to work with proxy advisors, investors and other stakeholders to develop a balanced and thoughtful approach to this area that better serves the interests of all market participants. Thank you for your consideration of our comments.

Sincerely,

Kevin Cameron  
Executive Chair

Nichol Garzon-Mitchell  
Senior Vice President, General Counsel

cc: Chairman Jay Clayton  
Commissioner Robert J. Jackson, Jr.  
Commissioner Hester M. Peirce  
Commissioner Elad L. Roisman  
Commissioner Allison Herren Lee