CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Roundtable on the U.S. Proxy Process; File No. 4-725

Dear Mr. Fields:

The U.S. Chamber of Commerce appreciated the opportunity to participate in the November 15th Securities and Exchange Commission ("SEC" or "Commission) staff roundtable on the U.S. proxy process. We believe that the roundtable served as an important step towards implementing much-needed reforms to the proxy system. This letter is a follow up to our November 12th letter for the comment file, and a response to some of the discussion that occurred during the roundtable.

Proxy Advisory Firms

As the Chamber pointed out in our November comment letter for the roundtable, we have long been concerned about the concentration, conflicts of interest, and lack of transparency in the proxy advisory system. The industry is an oligopoly dominated by Institutional Shareholder Services (ISS) and Glass Lewis, both of which operate with serious deficiencies that impact the quality and impartiality of information relied upon for proxy voting decisions. The two firms also have a significant level of influence over the manner in which public companies are operated. All of these factors harm our capital markets, impair capital formation, and discourage companies from going and staying public.

One key takeaway from the November 15th roundtable is that there is no uniform, baseline set of regulations or even standards that apply to the proxy advisory industry. Just about every other market participant in the proxy process – brokers, banks, transfer agents, asset managers, public companies – are subjected to at least some type of regulatory oversight. The lack of an oversight regime for proxy advisory firms stands in stark contrast to past determinations made by the SEC and Congress regarding the need to oversee and regulate the proxy process for public companies.

The roundtable also reinforced that the two largest proxy advisory firms view their roles and responsibilities very differently. ISS has chosen to register under the Investment Advisers Act and holds itself out as a fiduciary, stating that "we have a fiduciary obligation to our clients to provide advice that is in their best interest."[1] Glass Lewis, on the other hand, has chosen not to register at all with the SEC and therefore presumably does not view itself as a fiduciary.

Furthermore, ISS continues to operate a consulting business to issuers in addition to its core institutional investor business. ISS claims that such a business model is not a problem because of the way it manages conflicts, and claims the existence of a "firewall" between the two divisions. Glass Lewis, meanwhile, stated in a recent letter to members of the Senate Banking Committee that "unlike ISS, Glass Lewis does not provide consulting services to issuers. *We believe the provision of consulting services creates a problematic conflict of interest that goes against the very governance principles that proxy advisors like ourselves advocate."*[2] (emphasis added).

Even more concerning is that without regulatory oversight, proxy advisory firms have begun to subvert the regulatory authority of the SEC by imposing their own requirements on public companies. According to the recently released 2019 Glass Lewis proxy voting guidelines, Glass Lewis stated they "will also be making note of instances where the SEC has allowed companies to exclude shareholder proposals, which may result in recommendations against members of the governance committee."[3]

This conflicts with a point made on the second panel of the proxy roundtable, where several participants noted the SEC's process for excluding shareholder proposals as a way for companies to ensure that shareholder proposals are to the benefit of all shareholders. However, if issuers follow the SEC's process for excluding shareholder proposals – as has long been allowed under Rule 14a-8 of the

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[1] ISS Comment Letter for November 15 Roundtable
[2] http://www.glasslewis.com/wp-content/uploads/2018/06/Glass-Lewis-Response-to-May-9-2018-Chairman-Heller-Letter_0601_FINAL.pdf
[3] http://www.glasslewis.com/wp-content/uploads/2018/10/2019_GUIDELINES_UnitedStates.pdf

Exchange Act – it is now possible that they will be penalized by negative voting recommendations from proxy advisory firms.

We can think of no other area under the securities laws where two dominant market participants in the same industry, with little or no oversight, operate under two completely different sets of rules and standards – with one of those participants choosing not to register with the SEC at all. While commenters may disagree as to the proper regulatory regime for proxy advisors, we think there should be broad agreement that allowing proxy advisory firms to choose their own regulatory model is not the right approach. From the Chamber's viewpoint, we believe that the business and regulatory models of *both* ISS and Glass Lewis are deficient, and would advocate for minimum standards that can be achieved in part through use of the SEC's exemptive authority (discussed in more detail below).

This impacts the ability of investors to acquire the useful information necessary to determine if they should vote in a shareholder proposal or director contest and how they should vote. These decisions may impact the ability of investors to maximize return for their clients.

In short, inadequate oversight of the proxy advisory firms harms investor protection, competition and capital formation.

One-Size-Fits-All Voting Recommendations

As Chairman Clayton noted at the roundtable and in a recent speech, the proxy advisory system works best when voting recommendations take into account the *specific* circumstances of companies. One-size-fits-all recommendations, or overly broad "benchmark" policies developed by proxy advisory firms, cannot reflect the unique characteristics of individual issuers, and thus ultimately impair the quality of information that informs proxy voting decisions. A shareholder that trusts a fiduciary is not asking for "consistent" voting, but responsible voting that takes into account company-specific factors that will drive returns.

The inability of proxy advisory firms to make recommendations on a case-by-case, company-by-company basis has long been a problem. In the case of ISS, the adoption of annual benchmark policies typically occurs after a perfunctory and very brief public "consultation," and there is little transparency surrounding how ISS makes changes to its benchmarks year after year. And while Glass Lewis claims to review each company on a "case by case" basis, it also routinely adopts broad benchmarks intended to apply to all companies, regardless of whether a particular benchmark may be appropriate for a specific issuer.

Furthermore, ISS claims to offer custom voting policies for its institutional investors and their clients to counter the "one size fits all" recommendations argument, noting in their comment letter that "as of January 1, 2018, approximately 85% of ISS' top 100 clients used a custom proxy voting policy."[4] However, what constitutes a "custom policy" is not abundantly clear. A custom voting policy could, for example, include a client's direction to vote with all of ISS' recommendations with the exception of one or two particular issues important to that client. Additionally, the use of a custom voting policy does not mean that a voting recommendation was analyzed to confirm its applicability and appropriateness for any specific company. For example, appearing before a December 6, 2018 Senate Banking Committee hearing, Assistant Comptroller for the New York City Office of the Comptroller Michael Garland stated that the Comptroller's office does not conduct a due diligence review of the proxy advisory firm's recommendations but instead only reviews whether the proxy advisor has implemented the Controller's custom voting guidelines, which are not company specific.

In 2014, ISS had a global staff of 250 research analysts to provide recommendations on 250,000 shareholder votes.[5] Based on this information, each ISS analyst was responsible for researching and preparing reports on 1,000 issues in the truncated period of the usual proxy season primarily between March and June. As of June 2017, the ISS Global Research team covered 40,000 shareholder meetings with approximately 270 research analysts and 190 data analysts.[6] Glass Lewis purports to analyze fewer issues but has fewer analysts to do so (approximately 200 in 2014), ensuring that its analysts are equally overwhelmed with their responsibilities in a short period of time. Glass Lewis recently reported it covers 20,000 meetings each year with approximately the same number of analysts it had in 2014.[7]

As Chairman Clayton iterated at the SEC's proxy roundtable as well as in his recent speech, "We also need clarity regarding the analytical and decision-making processes advisers employ, including the extent to which those analytics are company- or industry-specific. On this last point, it is clear to me that some matters put to a

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[4] https://www.sec.gov/comments/4-725/4725-4629940-176410.pdf
[5] http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/01/021874_ProxyAdvisory_final.pdf
[6] https://www.issgovernance.com/file/duediligence/Due-Diligence-Package-November-2017.pdf
[7] http://www.glasslewis.com/company-overview/

shareholder vote can only be analyzed effectively on a company-specific basis, as opposed to applying a more general market or industry-wide policy."[8] The Chamber emphatically agrees with Chairman Clayton, and we remain concerned that ISS and Glass Lewis continue to produce voting recommendations that fail to incorporate the individual circumstances of issuers and that they cast votes prior to their clients receipt and analysis of material information from issuers.

One example of ISS and Glass Lewis adopting one-size-fits-all recommendations is the position taken by both firms that *all* issuers should conduct annual votes regarding "say on pay." During consideration of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act,[9] Congress allowed such votes to be held annually, biannually, or triennially in order to allow companies flexibility to determine which vote frequency may be in their best interest. The decision of both ISS and Glass Lewis that votes be held annually contravenes the explicit intent of Congress, and is backed by no evidence or data to show that an annual vote is in the best interest of every public company.

The say on pay example is compounded by the fact that studies have shown proxy advisory firms "control" a significant amount of votes related to say on pay and in many cases a vote recommendation from ISS or Glass Lewis is the difference between a resolution passing or failing.[10] A recommendation for annual votes also embodies a glaring conflict of interest for both ISS and Glass Lewis – the greater the frequency of these votes, the more services these firms are able to solicit.

Another example of one-size-fits-all is proxy advisory firm policies related to so-called "overboarding" of public company directors. Both ISS and Glass Lewis have adopted arbitrary limits on the number of public company boards they believe individuals are capable of serving on. Some individuals may be fully capable of handling the workload involved with serving on multiple boards, and companies always seek the best talent to serve on their boards. Companies should ultimately decide whether an individual has the capacity and the time to fully discharge their responsibilities as a member of the board, and should not be hamstrung by arbitrary limits put in place by proxy advisory firms.

[8] https://www.sec.gov/news/speech/speech-clayton-120618
[9] P.L. 111-203 Section 951
[10] See e.g. Ertimur, Yonca, Ferri, Fabrizio and Oesch, David Shareholder Votes and Proxy Advisors: Estimates from Say on Pay (February 25, 2013); Copland, Larcker, Tayan Proxy Advisory Firms: Empirical Evidence and the Case for Reform (May 2018)

As described in our November 12th comment letter and in testimony before the Senate Banking Committee on December 6th, we believe an appropriate step for the SEC to take would be to condition a proxy advisory firm's exemption from the proxy solicitation rules under the Exchange Act upon that firm meeting a minimum set of standards, including:

- Ensuring that any recommendation the firm makes is not based on materially inaccurate information or unsubstantiated assumptions, by requiring that the proxy advisor:
    - Identify any information the firm is using in the analysis which is contested by the issuer or differs from the information disclosed by the issuer; and
    - Include a written justification for why the issuer's disclosed information was not used
- Adequately disclosing and otherwise managing any conflicts of interest;
- Providing an issuer with adequate time to meaningfully review a recommendation and, relatedly, the proxy advisory firm should accept engagement requests by the issuer before publishing a recommendation and include a requirement for the proxy advisor to disclose the nature of the engagement, or if denied an engagement request, explain the reasons for such a denial;
- Not proceeding with any automatic voting of client proxies if a company contests an adviser's recommendations so that the client has an opportunity to review both the adviser's explanation and any additional information the company may choose to provide and can make its own fully formed voting decision;
- Explaining in sufficient detail the proxy advisory firm's methodologies and how the proxy advisory firm has adhered to our deviated from such methodologies in determining each recommendation as to an issuer, including the extent to which the firm has relied on the recommendations, analysis, or rankings of any third party and, if so, which ones;

- Explaining in sufficient detail the reasons for the proxy advisory firm's peer group selection(s) if it has chosen to construct its own peer group in lieu of the issuer's, including a detailed description of the impact of the proxy firm's decision to change an issuer's peer group and how the analysis or resulting recommendation of an issuer's executive compensation program would have differed had the issuer's own peer group been used; and

- Explaining in sufficient detail why the proxy advisory firm has determined that any one-size-fits-all recommendations are appropriate given the particular facts and circumstances of the issuer and how the analysis or resulting recommendation would have differed had the issuer's own disclosed performance measures been utilized.

Resubmission Thresholds

The decline in public companies is a multifaceted issue with no single solution. A number of factors contribute to this problem, including those outside the control of Congress or the SEC—such as the availability of private capital or market conditions that can make the public markets unattractive. However, there are several issues squarely within the purview of the SEC that were discussed at the roundtable that can and should be addressed to help bring our capital markets into the 21st century so that they can drive much-needed growth. Those issues include proxy advisory firm reforms as discussed earlier as well as shareholder resubmission thresholds. As Chairman Clayton noted in his New York speech on December 6, 2018, a lot has changed since the current resubmission thresholds have been in place since 1954.[11] In fact the retail investor/institutional investor proportions of the marketplace have flipped during the last 64 years.

As stated in the Chamber's 2018 zombie proposal report, had the SEC implemented a new resubmission threshold, such as one based off of the 1997 SEC proposal of 6%-15%-30% prior to the period examined (2001-2018), only 27% of the 723 zombie proposals over that time would have been eligible for a fourth year on company ballots. Additionally, some of the proposals examined were resubmitted up to 12 times.

While we think it is important to give shareholders a voice in the proxy process, at some point it is important to listen to other shareholders as well, which in

[11] https://www.sec.gov/news/speech/speech-clayton-120618

many cases is a significant majority. In fact, under the current thresholds a proponent is allowed to resubmit a proposal even if nearly 90% of shareholders vote against it on multiple occasions. According to the Manhattan Institute, an ISS recommendation that shareholders support a given proposal corresponds with a 15% increase in the shareholder vote. As the Manhattan Institute's Proxy Monitor Report in 2017 notes:

> Given the empirical evidence that a recommendation by the proxy-advisory firm ISS that shareholders vote 'for' a given shareholder proposal is associated with a 15% boost in the proposal's shareholder vote, all else being equal, the current SEC rule means that ISS (and probably Glass Lewis, its principal competitor) effectively serves as the gatekeeper for shareholder-proposal resubmissions: if ISS supports a proposal, it can remain indefinitely on the ballot.[12]

In 2018, ISS supported 95% of the perennially defeated but resubmitted proposals, or "zombie" proposals, examined. ISS has recommended voting "for" 79% of certain zombie proposals at least one of the times they have appeared on the ballot since 2001. This creates a system where resubmissions of shareholder proposals are not determined by a majority of shareholders but rather the recommendations of ISS. In surveying 2018 shareholder proposals as of October 29, we have found that of the 268 proposals submitted by corporate gadflies, only 24 proposals passed. Therefore, 91% of the proposals submitted by these proponents failed in 2018. In this case, a small subset of shareholder corporate gadflies can continually subvert the voice of the majority of shareholders in terms of shareholder proposals.

These zombie proposals pose an enormous cost in terms of corporate resources spent to deal with proposals every year. Company costs including expenses determining whether the proposal meets SEC requirements, challenging the proposal, drafting language for the proxy statement, printing and mailing costs, and proxy solicitation costs. Continually resubmitted shareholder proposals can create distractions for management and boards, which have a fiduciary duty to focus on the long-term best interests of the company. Continually we hear from our public companies that they are increasingly focused on transformation within their industry at a time when there is as much disruption as we have seen since the industrial revolution. Shareholder proposals, particularly those that deal with social or political issues with no bearing on long-term shareholder value, only distract from the efforts

[12] https://www.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf

of the board and management when seeking to implement long-term strategies to remain viable.

If a shareholder proposal is repetitively introduced, despite little or declining support, at what point is the will of the majority of shareholders thwarted?

Further, what is the harm in taking a break for a period following thoughtful consideration by shareholders over several years?

While some on the shareholder proposal panel at the SEC's proxy roundtable argued that shareholder proposals weren't systemic enough to justify action by the SEC and their limited resources, we disagree. For those companies dealing with resubmitted shareholder proposals, particularly that don't aim to increase long-term shareholder value, they represent a large cost and time-resource burden. Additionally, the SEC has to expend resources to review and rule on no-action letters to exclude shareholder proposals. Not only that, but as Chairman Clayton iterated in his recent speech, "when looking at the ownership and resubmission thresholds, we need to consider the interests of the long-term retail investors who invest directly in public companies and indirectly through mutual funds, ETFs and other products."

Updating the thresholds would not in any way "disenfranchise" shareholders, as it would still allow shareholders who meet current holding requirements to submit a proposal. However, it would not subject others, particularly long-term shareholders, to the costs and distractions that occur when unpopular proposals are repeatedly included in a company's proxy statement.

Sincerely,

Tom Quaadman