Public Statement

Statement at Proxy Process Roundtable

Nov. 15, 2018

Good morning and thank you to the Divisions of Corporation Finance and Investment Management for organizing this roundtable. I hope that everyone here will take this opportunity to engage in a thoughtful, meaningful discussion on the proxy process. If the process were perfect, we would not be here today. The topics on the agenda have the tendency to get emotional. Trust me, we know where most, if not all, of you stand on the issues. You have a platform today and I hope you use it to provide us with specific examples, data, and facts rather than generalities or anecdotes. With the knowledge you gather today, you can then submit data to the comment file based on these discussions. We look forward to these submissions and your suggestions on how the SEC can make changes to improve the process.

The first panel today will address the proxy voting process and technology. While this topic is very broad and the panel very large, I hope that you will get the chance to address a few subjects that I think are very important to the proxy voting process.

- The current proxy voting process and system were developed decades ago. If we were to start from scratch, what changes would we make?
- Companies are required to disclose in their proxy statements the treatment and effect of broker non-votes. When brokers hold shares in street name for the benefit of other investors, generally they may not cast votes on non-routine matters (possibly apart from votes that count toward quorum) unless they have received specific instructions from the beneficial owners. This is a construct of stock exchange rules, which the SEC approves, as well as the Dodd-Frank Act.[1] Passive index fund managers, however, may vote shares without having a prior obligation to reach out to individual investors concerning their voting preferences. Does this distinction make sense, especially considering the Commission's proposed Regulation Best Interest?[2] Should asset managers reach out to the underlying holders to understand their voting preferences?
- Critical to the corporate-shareholder ecosystem is confidence that votes are being counted accurately. As this function is often outsourced, who has the responsibility to ensure an accurate vote count? Should companies, voting intermediaries, or participants do more, especially when the outcome appears to be a close call? How do investors know that their votes were actually cast, and are they affected by practices such as securities lending?

The second panel today will focus on shareholder proposals. I want to stress the importance of shareholders being able to engage with management of companies, and not just in the context of annual meetings. Shareholders are the owners of a company and have the right for their voices to be heard. Shareholder proposals are a means for long-term shareholders to engage with both management and other shareholders. Sometimes, this right to vote is not enough for certain shareholders to express their views or displeasure about a topic, such as in instances when the board is unaware of a matter important to shareholders or unwilling to bring that matter to a vote. We have to strike a balance, though, between proponents who seek to increase shareholder value with their proposals and those who exploit the process to further their personal agenda. Proposals brought by the latter can be a waste of shareholders' time and money, as it is the shareholders who ultimately bear the costs companies spend defending these proposals.

One area that I would encourage participants to discuss is the eligibility requirements for shareholder proposal submissions and resubmissions. The Commission last considered the thresholds for shareholder proposal submissions and resubmissions in 1998, and we have no economic analysis to support the current thresholds.[3] A lot has changed in twenty years, and I think it is appropriate for us to consider whether these thresholds are still appropriate and to do so in a reasoned way.

- For shareholder proposals, is the monetary threshold still appropriate in light of inflation or other changes in the marketplace? Is a monetary threshold appropriate at all? What about percentage of shares held? Should that be one-size-fits-all, or tailored to a company's public float or number of outstanding shares? The required holding period should be reconsidered, as well. What period of time is long enough to determine that a shareholder proposal is being proposed by someone who shares the concerns of long-term shareholders?

- I am also interested to hear your perspectives on resubmission thresholds. Are they appropriately set to ensure that the same unpopular proposal (or a slight variation of such a proposal) is not presented to shareholders year after year?
- Additionally, I am interested to hear your thoughts on "proposal by proxy." I am aware that the Division of Corporation Finance stated last year that it is of the view that a shareholder's submission by proxy is consistent with Rule 14a-8.[4] How is it in the long-term interest of shareholders to allow this practice when the person bringing the proposal either is not a shareholder or cannot qualify to bring the proposal on his or her own? How does this practice protect investors?

The last panel will discuss proxy advisory firms, which have increasingly played a central role in advising fund managers on how to vote proxies and thereby influencing outcomes for fund investors. Given this role, I believe the SEC, fiduciaries that use their services, and members of the shareholder-voting ecosystem must assess how these firms operate and manage conflicts of interest.

- Proxy advisors, particularly the largest firms (ISS and Glass Lewis) have notable conflicts of interests that arise from their affiliations, including their ownership and major customers, as well as from their other business activities, such as advising public companies on corporate governance and perhaps even providing services in addition to voting recommendations to activist hedge funds. How are these firms managing such conflicts when formulating voting recommendations? How are these conflicts disclosed to their customers? Does ISS operate under different obligations because it is an SEC-registered investment adviser while other proxy advisors are not?
- Given the large role that they have, are proxy advisory firms becoming de facto standard setters and influencing corporate behavior?
- Accuracy of the facts underlying voting recommendations is another important issue. How are proxy advisors ensuring they produce voting recommendations based on accurate information? What controls do proxy advisors have in place? And, what opportunity exists for public companies to discuss a potential recommendation or correct erroneous information that the proxy advisor has published? While, in some instances, S&P 500 companies are given the opportunity to review ISS' recommendations before publication, smaller companies have no access to ISS.[5] Wouldn't all companies (and their shareholders) benefit from a meaningful rebuttal period?
- Next, how do proxy advisory firms' voting guidelines serve the interests of investors?[6]
- Should regulations address how proxy advisors prioritize the varying interests of investors and otherwise develop and justify their recommendations?

Finally, fund managers have evolved to play an outsized role in voting proxies — particularly managers of diversified passive funds, which hold shares in thousands of public companies on behalf of millions of Main Street investors. These investment advisers have a fiduciary duty to the funds they advise. I hope the panels today, and subsequent comment letters, will discuss how they are, or should be, fulfilling this duty in the context of proxy voting.

- Are fund managers seeking to vote proxies in ways that maximize the value of company stock to their shareholder investors? What data is used to justify their decisions? Are the reasons for fund managers' voting practices adequately explained to fund investors? To what extent are fund voting decisions decoupled from a fund's portfolio management?
- If an adviser manages funds with differing objectives (such as an ESG-focused fund vs. a fund focused on stocks that pay large dividends), does it cast votes on the same proxy proposals differently for the different funds?
- To what extent are advisers relying on proxy advisor recommendations as a means to minimize a fund's costs of analyzing and voting proxies? By focusing on minimizing costs, are advisers utilizing less bespoke recommendations from proxy advisory firms regarding each issuer held by the fund, despite different funds having differing objectives?
- When utilizing services of a proxy advisory firm, how are the fund managers continually diligencing these recommendations and holding these firms accountable?
- Do fund managers analyze how past votes have affected shareholder value or otherwise served a fund's objectives, especially with respect to M&A activities?
- Finally, what additional guidance should the SEC provide to assist fund managers in this context?

I look forward to hearing everyone's suggestions for improvement, and I ask that you keep in mind when you ask for change that the SEC must take a balanced approach to rulemaking. Any changes that we make must promote capital formation, promote market integrity, and protect investors.

[1] *See* NYSE Rule 452 and Section 952 of the Dodd-Frank Wall Street Reform Act of 2010.
[2] Regulation Best Interest (Proposed Rule), File No. S7-07-18 (Apr. 18, 2018).
[3] *See* Exchange Act Release No. 34-40018 (May 21, 1998) (adopting), where the Commission increased the dollar value of a company's voting shares that a shareholder must own in order to be eligible to submit a shareholder proposal but decided not to adopt the proposed increase to resubmission thresholds.
[4] Staff Legal Bulletin No. 14I (CF) (Nov. 1, 2017).
[5] According to the ISS website: "For determining which companies are eligible for a draft review, ISS generally uses the S&P 500 constituent list as of January 31st for annual meetings occurring during the following proxy season." *Available at* https://www.issgovernance.com/iss-draft-review-process-u-s-issuers/.
[6] Some guidelines appear arbitrary, or at least untethered to legal requirements or metrics. For example, ISS' guidelines state that it generally favors voting for resolutions that require disclosures on Climate Change/Greenhouse Gas Emissions without mentioning any legal requirements on companies to do so, value justifications, or thresholds of materiality to investors. *See, e.g.*, ISS' United States Proxy Voting Guidelines, at 57 (guidelines generally favor voting for resolutions requiring disclosures on Climate Change/Greenhouse Gas (GHG) Emissions with no mention of whether this information is material to investors). Other guidelines I have seen actually appear to *undermine* legal authority. Glass Lewis' 2019 Proxy Paper Guidelines state that it will make note of instances where a public company has successfully petitioned the SEC to exclude shareholder proposals and potentially recommend against members of the company's governance committee. *See, e.g.*, Glass Lewis' 2019 Proxy Paper Guidelines, at 29 ("Glass Lewis will make note of instances where a company has successfully petitioned the SEC to exclude shareholder proposals. If after review we believe that the exclusion of a shareholder proposal is detrimental to shareholders, we may, in certain very limited circumstances, recommend against members of the governance committee.").