Public Statement

Statement on Proxy-Advisor Guidance

Commissioner Robert J. Jackson Jr.

Aug. 21, 2019

I want to begin by expressing my appreciation to Division Directors Dalia Blass and Bill Hinman, and the terrific Staff in the Divisions of Investment Management and Corporation Finance, for their hard work in advance of today's meeting. I'm also deeply grateful to my colleague Elad Roisman, whose work in this area is an exceptional example of effective, thoughtful leadership.

The guidance before us today addresses advice investors use in corporate voting. By informing and empowering investors ahead of corporate elections, that advice can help hold insiders accountable for how they run America's public companies. I'm concerned that today's guidance may alter the competitive landscape for the production and use of that advice—without addressing whether doing so might make it harder for investors to oversee management. I therefore respectfully dissent.

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Monitoring public companies is difficult and costly, and many investors lack the time and money to do it.[1] Even institutions who manage the savings of millions of Americans can lack incentives to engage in corporate oversight.[2] That's why those institutions seek advice about how they should vote at thousands of corporate elections each year. The advice that drives their votes comes from many sources—including the proxy advisory firms who provide it for a fee.

Today's guidance identifies steps institutional investors can take to ensure that their use of proxy voting advice complies with their fiduciary duties. Many large institutions already take some of these steps, but smaller ones may be less able to bear the costs of doing so.[3] If smaller investors respond to these costs simply by choosing to vote less, the result may be to give more influence to large institutions.[4] We should carefully consider the consequences of that possibility before making policy in this area.

Similarly, the proxy-advisory industry itself is dominated by a small number of players, further concentrating voting influence into just a few hands.[5] Important recent research shows that the entrance of new competitors has helped proxy advisors produce better and less conflicted advice.[6] But I worry that today's guidance may make it more costly to run a proxy-advisory firm, encouraging even more concentration—rather than new entrants who can give investors more choices about how to vote.

The role of proxy advisors has been hotly debated for decades, with strong views on all sides.[7]But one thing we know is that a competitive market for voting advice benefits both investors and issuers by generating crucial accountability for companies and proxy advisors alike. I would have considered the effects of today's guidance on the competitive landscape more fully before taking these steps.

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I hope that investors will continue to engage with the Commission on these important issues—and come forward with hard evidence that can help us understand the effects our choices can have on the market for voting advice. But because we have not more deeply examined the implications of today's guidance for competition in corporate voting, I respectfully dissent.[8]

[1] The seminal work on monitoring amidst dispersed ownership is Adolf Berle & Gardiner Means, The Modern Corporation and Private Property (1932). Institutional investors can help address the collective-action problems inherent in that ownership model. Bernard Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 U.C.L.A. L. Rev. 811 (1992). But those institutions face both economic and legal limits on their own incentives to monitor management. John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 Colum. L. Rev. 1277 (1991). Proxy advisors can be thought of as a solution to that problem—but proxy advisors, too, have their own limitations. *See Rapanos v. United States*, 547 U.S. 715, 722 n.14 (2006) (opinion of Scalia, J.) (describing the famous allegory in which a guru affirms that "the Earth is supported on the back of a tiger. When asked what supports the tiger, he says it stands upon an elephant; and when asked what supports the elephant he says it is a giant turtle. When asked, finally, what supports the giant turtle, he is briefly taken aback, but quickly replies, 'Ah, after that it is turtles all the way down.'").
[2] Coffee, *supra* note 1. More recent work on the rise of index funds notes that those funds "have especially poor incentives to engage in stewardship activities that could improve governance and increase value." Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. Econ. Persp. 89 (2017).
[3] Importantly, institutional investors often base voting decisions on combined consideration of proxy-advisor recommendations and internal analysis generated by in-house analysts. Lucian A. Bebchuk and Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Colum. L. Rev. tbl. 1 (forthcoming 2019) (documenting the size of stewardship teams at three large institutional investors).
[4] For example, institutional investors often recall lent shares in advance of the record date in order to vote in a coming election. Reena Aggarwal, Pedro A.C. Saffi & Jason Sturgess, *The Role of Institutional Investors in Voting: Evidence from the Securities Lending Market*, 70 J. Fin. 2309 (2015). But today's guidance indicates that a "client and its investment adviser may agree that the . . . adviser would not exercise voting authority in circumstances [because of] opportunity costs for the client resulting from restricting the use of securities lending in order to preserve the right to vote." Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, at 11. To the degree that today's guidance leads relatively small investment advisers to recall shares at a lower rate than larger firms, the result may be to further concentrate voting activity at American corporations among the largest institutions. Aggarwal et al., *supra*, at 2332 & tbl. VI ("Large blockholders have more incentives to monitor the firm, which results in greater record date recall."); *see also* John Bogle, *Bogle Sounds a Warning on Index Funds*, Wall St. J. (Nov. 29, 2018) (expressing concern that concentrated ownership in large public companies "would [not] serve the national interest"); John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve*, at 1 (working paper) (Sept. 2018).
Another possibility, of course, is that large institutional investors themselves will vote less in light of today's guidance, especially to the degree that their indexing arrangements give them weak incentives to monitor. *See* Bebchuk & Hirst, *supra* note 3. In that case, we risk empowering corporate management at the expense of investors—a tradeoff we should carefully consider before making policy choices.
[5] David A. Katz & Trevor Norwitz, Wachtell, Lipton, Rosen & Katz, *Congress Increases Pressure on Proxy Advisory Firms*, Harv. L. Sch. F. Corp. Gov. and Fin. Reg. (May 23, 2018) (describing the claim that just two firms "control 97% of the proxy advisory industry"). As participants in our Roundtable last

Fall on this subject noted, the lack of competition among proxy advisory firms is a significant concern when making policy in this area. T.K. Kerstetter, *An Investor Perspective on the SEC's Proxy Roundtables*, Corporate Board Member ("'[The threat to competition] really concerns me.'") (quoting Ken Bertsch, Exec. Dir., Council of Institutional Investors); *see also* Securities and Exchange Commission, Roundtable on the Proxy Process 252 (Nov. 15, 2018) ("'So if you believe the public is well-served by diversity of opinions . . . you don't have that in this area. And so [the Commission should] examine: What are th[e] impediments?'") (quoting Sean Egan of Egan-Jones Proxy Services).

[6] Tao Li, *Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry*, 64 Mgmt. Sci. 2951 (2018). To be sure, proxy advisors that earn revenue from both issuers and investors face significant conflicts of interest, *see* Securities and Exchange Commission, Release No. 34-62495, *Concept Release on the U.S. Proxy System* (2010) (an issuer "may purchase consulting services from the proxy advisory firm in an effort to garner . . . support for the issuer"), but the evidence we have suggests that vigorous competition may be the best medicine for those conflicts, *see* Li, *supra*, at 2953 ("Overall, my results suggest that conflicts of interest are a real concern in the proxy advisory industry, and increasing competition can help alleviate them to a certain extent.").

[7] *Compare* Statement of the U.S. Chamber of Commerce on the Market Power and Impact of Proxy Advisory Firms (June 5, 2013) (describing "ISS and Glass Lewis [as] the de facto standard setters for corporate governance policies in the U.S.") *with* Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality*, 59 Emory L.J. 869 (2010) (finding that the largest proxy advisor's recommendation shifts, at most, 10% of overall shareholder votes).

[8] Commissioner Robert J. Jackson, Jr., *Competition: The Forgotten Fourth Pillar of the SEC's Mission* (Oct. 11, 2018) ("As the '33, '34, and '40 Acts read today, Commissioners must 'consider, in addition to the protection of investors, whether [an] action will promote efficiency, competition, and capital formation' when making rules.") (citing 15 U.S.C. §§77b(b), 77b(f), 80a-2(c) (2012)).