

Public Statement

Statement of Commissioner Allison Herren Lee On Proxy Voting and Proxy Solicitation Releases



Commissioner Allison Herren Lee

Aug. 21, 2019

Thank you, Chairman Clayton, and thank you to the staff in both the Division of Investment Management and the Division of Corporation Finance for your work on today's releases, including Paul Cellupica, David Bartels, Holly Hunter-Ceci, Tara Varghese, David Fredrickson, Tamara Brightwell, Ted Yu, Luna Bloom, Michele Anderson, and Adam Turk.

I also want to thank my colleagues on the Commission, as well as Directors Dalia Blass and Bill Hinman, for working with my office to address some of the issues that I raised in this process. Although I cannot support the Commission's actions today, I appreciate the responsiveness to some of my concerns and the collaboration that occurred.

We are dealing today with the critical issue of corporate democracy—the fundamental process by which the owners of companies protect their investments and ensure that their interests are being served. There can be no doubt that investment advisers have and retain important fiduciary duties with respect to proxy voting.

Today's proxy voting release,^[1] however, creates significant risks to the free and full exercise of shareholder voting rights.

First, it introduces increased costs and time pressure into an already byzantine and highly compressed process. Second, it calls for more issuer involvement in the process despite widespread agreement among institutional investors and investment advisers that greater involvement would undermine the reliability and independence of voting recommendations.^[2]

Significantly, we are creating these risks without notice and comment, without justifying the choices made to affected parties and the public,^[3] and without weighing the costs and benefits of the chosen course.^[4]

I understand there is a view that today's actions do not go beyond the staff guidance issued in 2014.^[5] But I do not agree. Staff views like those expressed in Staff Legal Bulletin 20 are non-binding and cannot create legal rights or obligations.^[6] Commission action, on the other hand, is different and commands attention and compliance.

Although the release states that the very detailed approaches to assessing a proxy advisory firm are just examples of how an investment adviser could meet its fiduciary duties with respect to proxy voting, many of those examples are presented as steps the adviser in fact **should** take.^[7] A regulated entity ignores such direction at its peril.

Today's release will have the practical effect of enshrining these examples in the policies and procedures of many, if not most, investment advisers and thereby increase costs for both investment advisers and proxy

advisory firms.

It may be that some of these specific measures are warranted, but the Commission has made a substantive policy choice without formally seeking input, justifying that choice to the public, or even identifying any benefits for investors.^[8]

In addition, today's release contains new substantive requirements – most notably, increased issuer involvement in the proxy advisory firm's process. The release embraces the policy view that issuer input will improve voting recommendations or make them more consistent with investors' best interests. Is this true? We don't know because we have not fully gathered, analyzed, and weighed the evidence.

To the extent we have any information, such as from the proxy roundtable in late 2018, we know that institutional investors and investment advisers have been clear that involvement by issuers would undermine the reliability and independence of a proxy advisory firm's recommendations.^[9] Today's release does not address or respond to those views, and, importantly, it does not justify why a contrary policy was chosen here, as would be required after notice and comment. Certainly, issuers have expertise and insight, but they also have a clear stake in the outcome. We should be mindful of that just as we are in other areas, such as promoting independence in analyst research.^[10]

The release also refers to "timely" input by issuers into what we know is an extremely compressed time period during the proxy season. But efforts to force more work by more people into an already tight timeframe seem likely to reduce the accuracy of the research, or worse make the use of proxy advisory services unworkable.^[11] What should we weigh these consequences against if we haven't gauged the value of issuer input?

We also have not addressed whether the changes adopted today will impose barriers to entry in the proxy advisory space, exacerbating what is already a highly concentrated market. And we have not addressed the effects of this release on shareholder voting participation. As Commissioner Jackson points out, investment advisers, especially small and mid-sized advisers, may be less inclined to vote or to accept voting authority if voting is more costly.

So what are the benefits to be achieved here? We don't have investment advisers clamoring for advice or certainty on how to meet their fiduciary duties, and we don't have those who use them—institutional investors—complaining that investment advisers are breaching those duties. So, what exactly are we fixing by calling for increased issuer input and injecting costs into the process? These are the questions we should be asking and answering before we act.

Finally, I cannot support today's release relating to the solicitation rules^[12] because (as reflected in the Regulatory Flexibility Agenda), the Commission may soon propose changes to the exemptions from those rules.^[13] Without knowing the extent or substance of those changes, neither the Commission nor the public can meaningfully evaluate the impact of today's action. In fact, it could cause market participants to adapt to a regulatory framework that the Commission may soon change.

The policy choices reflected in today's releases create serious risks to our system of corporate democracy by adding cost, adding time pressure and, potentially compromising the independence of voting recommendations. Because those risks have not even been identified, much less weighed and analyzed, I must respectfully dissent.

[1] Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Rel. No. [forthcoming] (Aug. 21, 2019), *available at* [hyperlink forthcoming] ("Fiduciary Release").

[2] While the two largest proxy advisory firms, Institutional Shareholder Services and Glass Lewis, already provide some opportunity for issuer input, such input is more limited than that envisioned in today's release. See Letter dated Nov. 14, 2018 from Katherine Rubin, CEO, Glass Lewis at 5-6 (explaining that Glass Lewis facilitates issuer review of a data-only version of its research reports prior to Glass Lewis completing the relevant analysis); and Letter dated Nov. 7, 2018 from Gary Retelny, President and CEO, ISS at 10 (describing ISS's process for providing companies included in the S&P 500 an opportunity to review a draft analysis for

factual accuracy, but indicating that such companies more often disagree with the report's interpretation or ISS's voting policies). As discussed below, today's release calls for more expanded issuer involvement, including in the formulation of a proxy advisor's internal methodologies, analysis, and voting policies.

[3] See *Appalachian Power Co. v. E.P.A.*, 208 F.3d 1015, 1024 (D.C. Cir. 2000) ("It is well-established that an agency may not escape the notice and comment requirements . . . by labeling a major substantive legal addition to a rule a mere interpretation."); See also Jacob E. Gersen, *Legislative Rules Revisited*, 74 U. Chi. L. Rev. 1705, 1714 (discussing *Hector v. U.S. Dept. of Agric.*, 82 F.3d 165 (7th Cir. 1996)) ("Notice and comment ostensibly allows an agency to receive public input from interested parties, thereby developing expertise. Notice and comment rulemaking both generates information and produces policy resulting from the participation of interested parties; that is, notice and comment rulemaking serves both technocratic and democratic aims. Indeed, rulemaking is taken by some to replicate a variant of the deliberative exchange to which Congress might aspire."); and U.S. Dept. of the Treasury, *A Financial System that Creates Economic Opportunities, Capital Markets* at 10 (Oct. 2017) ("Treasury also recommends that the SEC and the CFTC avoid imposing substantive new requirements by interpretation or other guidance.").

[4] See Investment Advisers Act of 1940, Section 202(c), 15 U.S.C. 80b-2 (requiring that the Commission, when engaged in rulemaking pursuant to the Investment Advisers Act, "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

[5] See SEC 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), available at <https://www.sec.gov/interps/legal/cfslb20.htm>.

[6] See *id.* ("The statements in this bulletin represent the views of the Division of Investment Management and the Division of Corporation Finance. This bulletin is not a rule, regulation or statement of the Commission. Further, the Commission has neither approved nor disapproved its content.").

[7] Without going into every instance where costs are increased, I note for example, that the release refers to sampling votes now both before and after they are cast, even going so far as to provide an approach to population selection. See Fiduciary Release, *supra* note 1, at 15. It states that an investment adviser "should consider the nature of **any** third-party information sources that the proxy advisory firm uses as a basis for its voting recommendations." [7] It refers to a review of the adequacy of a proxy advisory firm's staffing and personnel[7] and its use of technology. *Id.* at 17, 20.

[8] See *MCI Telecommunications Corp. v. F.C.C.*, 57 F.3d 1136, 1141 (June 27, 1995) (noting that the APA's requirement for notice and comment rulemaking "serves both (1) to reintroduce public participation and fairness to affected parties after governmental authority has been delegated to unrepresentative agencies; and (2) to assure that the agency will have before it the facts and information relevant to a particular administrative problem") (internal quotations omitted).

[9] See Letter dated Aug. 16, 2019 from Thomas P. DiNapoli, State Comptroller, New York at 1-2 (opposing measures—such as those in today's release—that may "undercut [proxy] advisors invaluable independence (the very thing investors pay for)"); Letter dated Dec. 31, 2018 from Gail C. Bernstein, General Counsel, Investment Adviser Association ("IAA Letter") at 5 ("[T]he discussion at the Roundtable highlighted that users of proxy advisory firm services do not necessarily want issuers interfering with the independence of the recommendations and analyses or influencing the content of the reports."); Letter dated Dec. 13, 2018 from Donna F. Anderson, Head of Corporate Governance, and Eric Veiel, Co-Head of Global Equity, T. Rowe Price ("T. Rowe Price Letter") at 2 ("We are significantly more concerned, frankly, with the potential for issuers to inappropriately influence the research provided by proxy advisors to their clients. We note the stark contrast in principle this would have to current rules in place for sell-side research, which generally aim to prevent issuers from influencing the research produced by investment firms."); Letter dated Dec. 11, 2018 from Marcie Frost, Chief Executive Officer, California Public Employees' Retirement System at 2 ("[W]e are opposed to any proxy rule changes that will grant issuers undue influence over the research that proxy advisory firms provide."); and Letter dated Nov. 9, 2018 from Lisa Woll, CEO, U.S. SIF: The Forum for Sustainable and Responsible Investment at 4 ("We do not support giving companies the automatic right to preview proxy advisory firm reports and to lobby the authors to change recommendations or requiring these firms to employ ombudsmen

to receive complaints. These provisions would give corporate management substantial editorial influence over reports on their companies.”).

[10] See Rick Fleming, SEC Investor Advocate, Remarks at SEC Speaks: Important Issues for Investors in 2019 (Apr. 8, 2019) at fn. 18 (“[T]he Commission historically has been reluctant to allow companies to influence the research provided to investors. Consider, for example, the rules currently in place for sell-side research, which generally aim to prevent issuers from influencing the research produced by investment firms . . . I ask, why should the principle be any different when it comes to the independence of voting recommendations?”); See also FINRA Rule 2241 (requiring broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to promote objective and reliable research and that prohibit, among other things, prepublication review of a research report by a subject company for purposes other than verification of facts”).

[11] See T. Rowe Price Letter, *supra* note 9, at 3 (“We therefore would have significant concerns with any proposed regulatory changes that would sacrifice the objectivity of proxy advisor reports or introduce delays in the proxy voting process that, in an already compressed and intensely seasonal voting cycle, could result in missed vote deadlines.”); Letter dated Dec. 13, 2018 from Karen Carraher, Executive Director, and Patti Brammer, Corporate Governance Office, Ohio Public Employees Retirement System at 4 (requesting that the SEC avoid taking any action that will compress the timelines for receiving proxy advisor research reports); and IAA Letter, *supra* note 9, at 5 (“[T]his approach is not likely to work in practice. In most cases, there will not be sufficient time to distribute reports to issuers, receive feedback from them, and then distribute reports to advisers and other users of these reports in time for them to vote. Indeed, the extremely tight timeline for the entire proxy voting process points to the need to address the process holistically as the first and highest priority.”).

[12] Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Rel. No. [forthcoming] (Aug. 21, 2019), *available at* [hyperlink forthcoming].

[13] See SEC Regulatory Flexibility Agenda, Spring 2019, RIN 3235-AM50, *available at* <https://reginfo.gov/public/do/eAgendaViewRule?pubId=201904&RIN=3235-AM50> (noting that “[t]he Division is considering recommending that the Commission propose rule amendments to address certain advisors’ reliance on the proxy solicitation exemptions in Rule 14a-2(b)”).