

[Securities Regulation Daily Wrap Up, TOP STORY—Advisory committee urges SEC to revise and reissue proxy proposals, \(Jan. 24, 2020\)](#)

Securities Regulation Daily Wrap Up

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Some committee members expressed frustration with what they perceived as a lack of economic analysis in the proposals and encouraged the Commission to address "proxy plumbing" before changing rules relating to proxy advisory firms and shareholder proposals.

By a 10-5 vote, the SEC's Investor Advisory Committee (IAC) approved a recommendation by the Investor-As-Owner Subcommittee to take steps to revise its rule proposals on [proxy advisory firms](#) and [shareholder proposal submission and resubmission thresholds](#). The recommendation urged the Commission instead to revisit its proxy system priorities on issues such as vote counting, vote confirmation, and universal proxy and to re-examine the proposals in accordance with the SEC's own guidance on economic analysis. Dissenters advised that the proposals are in the notice and comment stage and the issues raised by the subcommittee would be considered before adoption of any final rules, rather than advocating for repropoals on both matters.

Separately, the full committee adopted unanimously a recommendation by the Market Structure Subcommittee that the SEC consider disclosure related to rebate tiers offered by the market exchanges to brokers to determine if these practices result in unfair price discrimination.

Recommendation on proxy proposals and guidance. Presenting the subcommittee's [recommendations](#) on the Commission's proxy proposals and guidance, Subcommittee Chair John Coates of Harvard Law School said that as currently framed, the SEC's actions would not reliably achieve their stated goals and should be revamped. He added that the proxy system needs more basic reforms, including the requirement to count votes reliably. According to the recommendation, neither of the proposals clearly identify the particular problems that they are intended to remedy.

Regarding the proxy advisory firm proposal, the recommendation advises the SEC to revise and reissue the proposal to present a more balanced assessment. Coates pointed out that the proxy advisor proposing release has only a few short statements on the value of proxy advisory firms, while the rest are either mechanical or negative. The appendix to the subcommittee's recommendation enumerates several supposed benefits regarding the role of proxy advisory firms.

The proposal also does not comply with the Commission's self-imposed guidance relating to cost-benefit analysis, Coates said. It lacks a statement of the market failure or inadequacy of the current system that creates a need for change and a statement regarding the current regulatory state the proposal intends to address (such as Advisers Act Rule 206-4(6), which can be used against bad practices relating to proxy voting). Coates added that while the proposing release cites errors in proxy advisory firm reports on firms as justification for mandating that management pre-clear the firms' recommendations before they are sent to firm clients, it does not cite any evidence of these errors except for those provided by issuers, and other evidence suggests that the error rate is only 0.3 percent with no material outcomes.

The recommendation also criticizes the proposal for lack of consideration to how it might impact smaller and mid-size asset managers. In addition, Coates pointed to what he called an internal inconsistency of the proposal regarding conflicts of interest: the Commission states that it is not requiring the publication of firms' conflict of interest policies, but requiring that these policies be given to clients would be tantamount to publication of the policies.

The recommendation similarly criticized the lack of analysis in the Commission's proposal that would raise the share ownership thresholds for submitting shareholder proposals and restricting the ability to resubmit shareholder proposals that have failed in the past. According to Coates, the SEC proposal did not analyze trends in data on shareholder proposals over time or the kinds of shareholder proposals that would be excluded under the proposed rule, such as proxy access proposals. In addition, the proposal lacks any analysis of reasonable alternatives. Coates said that he would be open to the idea that the share ownership thresholds for shareholder proposals be raised, but it should be done incrementally, such as by 1 percent rather than jumping 3 percent.

Anne Simpson of CalPERS and Damon Silvers of the AFL-CIO, members of the Investor-As-Owner Subcommittee, expressed their support for the recommendation. Silvers said he believes there should be no change in the current thresholds, and that most corporate governance progress made in the past 30 years would not come about if it weren't for smaller shareholders putting these issues on the proxy ballot. Simpson added that, even as a large institutional investor, CalPERS recognizes that smaller investors can sometimes be "the canary in the coal mine" when it comes to issues relating to corporate governance. She also urged the Commission to take up proxy plumbing before getting into issues relating to proxy advisory firms and shareholder proposals.

Subcommittee member Heidi Stam, former managing director at Vanguard, dissented from her colleagues' recommendation, stating that she believes that the SEC's proposals have sufficient information to move forward. Some members of the full committee agreed with Stam. Jennifer Marietta-Westberg of Cornerstone Research said that a reproposal would be unnecessary because the Commission will review the subcommittee's concerns, including those about economic analysis, as part of the notice and comment period. Professor Paul Mahoney of the University of Virginia School of Law added that while he agreed with some of the points of the recommendation, there was no need for repropoals.

Barb Roper of the Consumer Federation of America said she strongly supports the recommendation and voiced her concern about the SEC's "egregious abuse of process concerning the content" of its rulemaking. The proposals "don't even pretend" to provide a full reflection of the issues, she said, and while people can provide comments, it is significantly more challenging to comment on economic analysis when the basis for the Commission's analysis is not revealed in the proposing release, Roper admonished.

The full committee voted 10-5 to approve the subcommittee's recommendation, with two abstentions. Committee member Stephen Holmes of InterWest Partners, who abstained from voting because he did not feel competent to vote yes or no, urged the SEC to enhance the proposals if they see an opportunity to improve its cost-benefit analysis. However, he expressed skepticism that the Commission should perform all the analyses outlined in the recommendation, fearing it might lead to "paralysis by analysis."

Following the vote, Coates thanked his colleagues for their input, but expressed disbelief that some thought issues related to economic analysis could be considered by the Commission on the basis of comment letters before any final rule is promulgated. Coates stressed that the Commission itself had adopted rulemaking guidance requiring that economic analysis be included in the proposal itself.

Exchange tier rebate disclosure. In contrast to the collegial but pronounced differences of opinion regarding the proxy proposals, the full committee unanimously [adopted](#) the recommendation by the Market Structure Subcommittee on disclosure of exchange rebate tiers. The recommendation points out that most stock exchanges utilize a "maker-taker" fee model where they pay a provider of liquidity a rebate fee and charge a fee to the taker of liquidity. Professor J.W. Verret of the Antonin Scalia Law School at George Mason University, who presented the subcommittee recommendation to the IAC, said that more disclosure is needed to determine whether rebate fee structures—which make it difficult for the end client to see the rebates that executing brokers obtain for their liquidity—exacerbate conflicts of interest.

The recommendation cites former SEC Chief Economist Chester Spatt, who opined at a March 2019 IAC meeting that the maker-taker platforms offer higher rebates to brokers sending larger amounts of orders that provide liquidity, which, in effect, rewards larger brokers and can act as a mechanism for price discrimination.

The subcommittee recommended that the exchanges provide regular disclosures to the SEC's Division of Trading and Markets about rebate tiers to permit the Commission to review the volume of trades that receive a rebate and a disclosure of rebate amounts broken down by volume ranges. In addition, the recommendation asks the SEC to require monthly public disclosure of rebate tiers by the exchanges.

Regarding the second recommendation on public disclosure, Verret said that the subcommittee only heard pushback from Nasdaq, which expressed concern about disclosing its clients' proprietary information. As a result, the recommendation suggests that the publicly disclosed data be aggregated and anonymized to limit proprietary concerns.

While supportive of the recommendation, Roper stated that she did not agree with anonymization of data, but requested that the record reflect that the SEC should only consider anonymization rather than impose it. This would make the SEC's oversight role more explicit, Roper explained. Verret acknowledged Roper's "friendly suggestion" about incorporating neutral language into the proposal, and the IAC voted 16-0 (with one member absent) to approve the recommendation.

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