Statement

Too Important to Regulate? Rolling Back Investor Protections on Proxy Voting Advice

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Over the past several years, much has been said about what the rise in fund ownership throughout our equity markets might mean for our economy.[1] But one outcome of increasing fund growth is clear: as funds come to own an ever larger percentage of U.S. corporate equities, they can influence the outcome of a variety of matters that companies submit to a shareholder vote.[2] As recently as a month ago,[3] the Commission acknowledged this fact and pursued policies designed to ensure that those who manage funds approach voting in a manner that serves the best interest of their clients.[4]

I. The Importance of Proxy Voting Advice to Investors

One cannot consider the implications of fund voting without also considering the role of those unique businesses that have become integral to the voting processes of *so many asset managers*: proxy voting advice businesses, also known as proxy advisory firms or proxy advisors.[5] Since fund portfolios often hold securities of many public companies, asset managers often face the prospect of voting on hundreds—if not thousands—of proposals relating to hundreds of fund portfolio companies each year, with the significant portion of those voting decisions concentrated in a period of a few months.[6] Proxy advisory firms offer services to assist them. Most substantively, these services include providing research and analysis regarding the matters subject to a vote; developing voting guidelines that asset managers can adopt; and making recommendations about how funds should vote on specific matters.[7] Proxy advisors also commonly provide electronic vote management systems through which asset managers can access not only their voting advice, but also proxy ballots pre-populated with the proxy advisor's voting recommendations, ready for submission to be counted.[8]

In the U.S., *two* proxy advisory firms serve almost the entire market,[9] providing proxy advisory services to *thousands* of funds each year that each exercise voting authority over a huge number of shares.[10] Given this widespread reliance on the services of such a small number of proxy advisors, it is clear that these firms' advice has the potential to affect a huge number of matters up for a vote across our markets.

The Commission has stated that it is a matter of *vital* importance to ensure that the voting advice these firms provide is based on the most accurate information reasonably available and that the businesses providing such advice be sufficiently transparent with their clients about the processes and methodologies used to formulate their advice.[11]

II. The 2020 Final Rules: Culminating Nearly a Decade's Worth of Work

To achieve these goals, the Commission engaged in a rulemaking process that was more extensive and thorough than is typical. We held a roundtable in 2018 and collected hundreds of public comments;[12] we proposed rules in 2019,[13] which accounted not only for the feedback from this roundtable but also from a decade's worth of comment letters the Commission had received on proxy voting matters after holding events addressing these issues in prior years.[14] We responded to comments received on the 2019 proposed rules by tailoring requirements in the final rules to address commenters' concerns, and we adopted the final set of rules just over a year ago (the "Final Rules").[15]

It is not an exaggeration to say that these Final Rules are the product of roughly a decade's worth of thinking and public feedback on how the Commission could promulgate regulations that would improve the quality of proxy voting advice available in our markets.

The Final Rules took a two-pronged approach to overseeing proxy voting advice, requiring proxy advisory firms to: (1) prominently disclose material conflicts of interest to their clients along with any policies and procedures regarding how the firm addresses such conflicts (referenced herein as the "conflict of interest disclosures")[16]; and (2) have written policies and procedures reasonably designed to ensure that (i) companies that are the subject of the proxy advisors' voting advice have such advice made available to them *at or prior to* the time such advice is provided to proxy advisory clients,[17] and (ii) clients (*i.e.* those asset managers who exercise votes on behalf of others, including retail investors) have a mechanism by which they can reasonably be expected to become aware of any written statements from those companies.[18] (I'll refer to these policies and procedures as the "engagement policies.")

Together, the conflict of interest disclosures and the engagement policies were intended to ensure that those who use proxy voting advice receive more transparent, accurate, and complete information on which to make their voting decisions.[19]

Sadly, the Final Rules were never permitted to take effect.[20]

III. Peeling Back Regulatory Protections . . .

Today's proposal is an explicit attempt to peel back their protections.

The proposal would remove the affirmative obligation on proxy advisory firms to have engagement policies.[21] This obligation was integral to the Final Rules as the Commission determined it would allow for investors to have access to more materially accurate, transparent, and complete information when they vote proxies.[22] The engagement policies were considered especially important protections for retail investors, who increasingly invest money in our markets through asset managers and rely on those managers to vote proxies in ways that serve their best interest, based on materially complete and accurate information.

Yet, the proposal would replace this obligation with . . . *nothing*.

It would not have the Commission impose any requirement that the proxy advisors have any form of an engagement policy. Oddly, the proposal attempts to justify this repeal by noting that a few of the proxy advisors already do similar things by way of engagement. But each practice that the proposal cites to support of this rationale *existed at the time* the Commission adopted the Final Rules.[23] Each was considered by the Commission and was either rejected as inadequate to accomplish the goals of the rulemaking, or it informed those requirements that the Commission believed should apply to *all* participants in the proxy advisory industry. In fact, the only development that seems to have transpired since we adopted the Final Rules is that the largest U.S. proxy advisory firm has decided to engage *less* with the companies it reviews—not more—which is a development overtly counter to the Final Rules.[24]

Should the proposal be adopted today, I see no reason to believe that the Commission will achieve the same important investor protections we hoped to attain through the Final Rules. And we should be clear about that result rather than pretend the proposal's effect will be so minimal.

A. . . . Without Clear Justification

Troubling to me, I found the proposal lacks many of the due process and procedural protections that usually guide Commission rulemakings. It does not squarely answer the question of *why* we would peel back our

existing rules, which were the product of substantial Commission and staff work and which had undergone the rigor of the Administrative Procedure Act. Nor does the proposal answer the question *why now*, before these rules have even taken effect.

One rationale is purportedly that investors who use proxy voting advice had "strong concerns."[25] But the sources supporting this claim include: a news article that quoted market participants both favoring and disfavoring the Final Rules[26] and a statement from one advocacy group on the day that the Final Rules were adopted speculating on their contents.[27] From *these* sources, it is impossible to discern what concerns investors actually have about the Final Rules.

The proposal does go on to cite a closed-door meeting that a group of 16 asset managers and five advocacy groups held with the Chair this past June, where those present "expressed concerns about the costs associated with the [Final Rules], including the Rule 14a-2(b)(9)(ii) conditions, and the general lack of corresponding investor protection-based benefits," in their view.[28] However, no other details about this seemingly determinative meeting are shared, including *how* the Final Rules fail to address these concerns. Nor does the proposal explain why the views of *these* particular market participants should be considered separately from those of *every other* market participant, who has weighed in during our lengthy rulemaking process or expressed opinions in the time that has followed.

We cannot forget that those who bear the consequences of asset managers' voting practices are ultimately the retail investors, who may have their life savings invested in funds run by asset managers. These individuals are the primary "investors" I believe the SEC is charged to protect. I do not see how we protect those Main Street investors by peeling back the protections our Final Rules would have effectuated.[29] Nor do I see how these individual investors will be served by lessening the obligations on investment advisers who vote proxies for the funds in which they invest, as the proposal also contemplates doing.[30]

IV. Special Treatment for Proxy Advisors?

In light of these considerations, the proposal suggests an entirely different approach to overseeing those entities whose actions the Commission so recently judged to materially influence investors and our marketplace.

A. Unusual and Surprising Deference to Self-Created Best Practices

Most notably, the proposal attempts to justify peeling back the Final Rules' protections by suggesting that Commission oversight of proxy advisory firms may be unnecessary. To support eliminating the Final Rules' requirement for engagement policies, the proposal deferentially recounts the recent efforts of proxy advisors to develop industry-wide standards through a "Best Practices Principles Group"[31] and references a report of this group's "Independent Oversight Committee" that found all six proxy advisors in this group met the standards established in the three best practices principles.[32]

While I agree that these industry efforts to create and uphold standards appear positive, they are hardly well enough established for this Commission to consider them as replacements for key provisions of our recently adopted Final Rules. This Best Practices Principles Group is a consortium of six proxy advisory firms, including those two that have the most far-reaching influence over the U.S. market[33]—these are the very firms the Commission sought to more closely regulate when it enacted the Final Rules. The current best practice principles themselves are barely two years old.[34] Indeed the oversight committee that reviewed proxy advisors' adherence to them is *the inaugural* committee conducting its *first review*.[35] And, while the plan going forward for this oversight committee seems to be that its members will be fully independent of the proxy advisory firms themselves, for purposes of composing *this* inaugural committee, it was the proxy advisors in the group that "made final selections of members to serve."[36] Moreover, the committee's budget is funded by the proxy advisors whose practices are subject to review (with half of the funding coming from the two largest U.S. proxy advisors).[37]

This is not the same as Commission regulation.

Nor am I aware of meaningful precedent for the deference with which the proposal appears to discuss these nascent efforts at self-regulation. We have not historically allowed a consortium of market participants to make

up their own rules—or principles and standards, in this case—to follow, with no Commission oversight or engagement.[38]

B. Would We Really Limit Liability for Making False Statements?

Along these same lines, the proposal would also remove a note from the text of Rule 14a-9, which the Final Rules recently added, and would replace it with certain guidance as articulated in the proposal's release.

The rationale for this change is puzzling. Note (e) of Rule 14a-9 articulated that "the failure to disclose material information regarding proxy voting advice…could, depending upon particular facts and circumstances, be misleading within the meaning of the rule."[39] According to the proposal, the addition of Note (e) appears "to have unintentionally created a misperception … [purporting] to determine or alter the law governing Rule 14a-9's application and scope, including its application to statements of opinion."[40] However, the proposal cites no sources which make this claim about the *actual* Final Rules. Instead, the proposal cites several comment letters *on the original 2019 proposed rules*.[41] The concerns outlined by those comment letters were specifically addressed in the Final Rules.[42] The proposal cites no source that Note (e), as understood *after* the explanation in the Final Rules' release, causes any "misperceptions" warranting deletion. And the proposal admits that there are no significant benefits to deleting the note other than avoiding this purported misperception.[43] Given that the misperception was *already addressed and clarified* by the Final Rules, and that there is no other benefit to be had by deleting the note, I do not see why Note (e) of Rule 14a-9 should be removed.

The proposal notes that one alternative path considered in addressing this alleged misperception was to "exempt certain portions of proxy voting advice from Rule 14a-9 liability" altogether.[44] I appreciate that this course of action was not actually proposed here, yet the proposal does seek public input on this as a potential course of future action.[45] While I do not believe this was the likely intention, it seems to me that this change could effectively allow proxy advisors to *make false and misleading statements* when providing proxy voting advice without liability.

I cannot think of any other type of market participant that is allowed such leeway in conducting proxy solicitations. The Commission must apply its rules equally to all those we regulate, and our regulation of market participants who solicit proxies is no different. A carve-out from liability for making false and misleading statements is *not* aligned with our mission.

V. Conclusion

In sum, I cannot support this proposal and remain firm in my belief that the Final Rules should be allowed to take effect. They still offer the important investor protections the Commission aimed to achieve when they were adopted, and they would level the playing field for proxy advisory firms to compete in a transparent and improved manner.

Moreover, I urge the Commission to rethink this rulemaking process. Whereas the Final Rules were developed based on years' worth of information and deliberation, and support for their requirements was clearly delineated in a transparent administrative process, this proposal's rationale is not so well-supported and the process through which it was developed raises questions about its thoroughness. Offering such little transparency into our process or reasoning for considering dramatic changes to recently adopted rules can lead people to worry about the efficacy and longevity of our rulemakings. This is poor precedent for our Commission to overturn thoughtfully developed regulation so lightly. Thus, I respectfully dissent.[46]

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[1] *See*, *e.g.*, John C. Coates, "The Future of Corporate Governance Part I: The Problem of Twelve" (Sept. 20, 2018), at 14 https://corpgov.law.harvard.edu/wp-content/uploads/2019/11/John-Coates.pdf ("We are rapidly moving into a world in which the bulk of equity capital of large companies with dispersed ownership will be owned by a small number of institutions.")

[2] *See* Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, Rel. No. 34-93169 (Sept. 29, 2021), at 7 https://www.sec.gov/rules/proposed/2021/34-93169.pdf ("Funds own around 30 percent of U.S. corporate equities and in some cases funds hold a larger percent of a single company's stock. As a result, funds can influence the outcome of a wide variety of matters that companies submit to a shareholder vote, including matters related to governance, corporate actions, and shareholder proposals.") (Internal citations omitted).

[3] *See id*.

[4] *See id*. *See also* Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Release No. 5325 (Aug. 21, 2019), https://www.sec.gov/rules/interp/2019/ia-5325.pdf (hereinafter "Adviser Proxy Voting Guidance"); Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5547 (July 22, 2020), https://www.sec.gov/rules/policy/2020/ia-5547.pdf (hereinafter "Advisor Robo-Voting Guidance"). *See also* Proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Rel. No. 34-87457 (Nov. 5, 2019), https://www.sec.gov/rules/proposed/2019/34-87457.pdf (hereinafter, "2019 Proposed Rules") (addressing obligations of those businesses that provide proxy voting advice, including to investment advisers); Exemptions from the Proxy Rules for Proxy Voting Advice, Rel. No. 34-89372 (July 22, 2020), https://www.sec.gov/rules/final/2020/34-89372.pdf (hereinafter, "Final Rules") (adopting final rules for proxy voting advice businesses).

[5] *See* Adviser Proxy Voting Guidance, *supra* note 4.

[6] *See* 2019 Proposed Rules, *supra* note 4, at 7.

[7] *Id*. at 8.

[8] *Id*. at 9.

[9] Final Rules, *supra* note 4, at 152.

[10] The largest proxy advisory firm in the U.S. (Institutional Shareholder Services, or "ISS") reported that it had approximately 2,000 institutional clients in 2019. Another major firm, Glass, Lewis & Co., LLC ("Glass Lewis"), reported that, as of 2019, it had "1,300+ clients, including the majority of the world's largest pension plans, mutual funds, and asset managers, who collectively manage more than $35 trillion in assets." 2019 Proposed Rules, at 10, note 18.

[11] 2019 Proposed Rules, at 10 ("Given these market realities, it is vital that proxy voting advice be based on the most accurate information reasonably available and that the businesses providing such advice be sufficiently transparent with their clients about the processes and methodologies used to formulate the advice.")

[12] *See* Roundtable on the Proxy Process (Nov. 15, 2018), comments available at https://www.sec.gov/proxy-roundtable-2018.

[13] *See* 2019 Proposed Rules *supra* note 4.

[14] *See* Proxy Voting Roundtable (Feb. 19, 2015), comments available at https://www.sec.gov/comments/4-681/4-681.shtml; Roundtable on Proxy Advisory Services (Dec. 5, 2013), comments available at https://www.sec.gov/spotlight/proxy-advisory-services.shtml. *See also* Concept Release on the U.S. Proxy System, Rel. No. 34-62495 (Jul. 14, 2010), https://www.sec.gov/rules/concept/2010/34-62495.pdf, comments available at https://www.sec.gov/comments/s7-14-10/s71410.shtml.

[15] *See* Final Rules, *supra* note 4.

[16] *See* Exchange Act Rule 14a-2(b)(9)(i).

[17] *See* Exchange Act Rule 14a-2(b)(9)(ii)(A).

[18] *See* Exchange Act Rule 14a-2(b)(9)(ii)(B).

[19] *See* Final Rules, at 1.

[20] *See* Securities and Exchange Commission, Division of Corporation Finance, “Statement on Compliance with the Commission’s 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9” (June 1, 2021), https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01; Chair Gary Gensler, “Statement on the application of the proxy rules to proxy voting advice” (June 1, 2021), https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01. *See also* Commissioner Hester M. Peirce & Commissioner Elad R. Roisman, “Response to Chair Gensler’s and the Division of Corporation Finance’s Statements Regarding the Application of the Proxy Rules to Proxy Voting Advice” (June 1, 2021), https://www.sec.gov/news/public-statement/peirce-roisman-response-statements-application-proxy-rules-060121.

[21] Proposed Amendments on Proxy Voting Advice, Rel. No. 34-93595 (Nov. 17, 2021) (hereinafter, the “Proposal”), https://www.sec.gov/rules/proposed/2021/34-93595.pdf (“We are proposing to amend Rule 14a-2(b)(9) by deleting paragraph (ii) and rescinding the Rule 14a-2(b)(9)(ii) conditions.”)

[22] Final Rules, at 87 (“We therefore believe that ensuring that registrants have timely notice of proxy voting advice and that proxy voting advice businesses provide clients with a mechanism by which they can reasonably be expected to become aware of any written response by registrants to that advice—in a timely manner—will increase confidence across participants in the proxy system that clients of proxy voting advice businesses, whether those clients are investors or are acting on behalf of investors, have timely access to transparent, accurate, and complete information material to their voting decisions.”)

[23] *See id*. at 157-160; *see also id.* at 185-193 (references to “existing practices”).

[24] *See* Cimi Silverberg and Caprice Herjavec, “ISS Discontinues S&P 500 Proxy Report Draft Review Process,” FW Cook (Nov. 5, 2020), https://www.fwcook.com/Blog/ISS-Discontinues-SP-500-Proxy-Report-Draft-Review-Process/.

[25] Proposal at 12-13.

[26] *See id*. at note 23, citing Peter Rasmussen, *Divided SEC Passes Controversial Proxy Advisor Rule*, Bloomberg Law (Jul. 29, 2020), *available at* https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-divided-sec-passes-controversial-proxy-advisor-rule. The Proposal cites this article for reporting certain criticism of the Final Rules from one source. It neglects to reference the rest of this article, which reports an alternative view from another source: “Rule proponents see the rules as a measured response to a significant problem of interest conflicts and erroneous reporting.”

[27] *See id*. at note 22, citing Council of Institutional Investors, *Leading Investor Group Dismayed by SEC Proxy Advice Rules* (Jul. 22, 2020), https://www.cii.org/july22_sec_proxy_advice_rules (“[T]he new rules . . . ***seem to*** effectively require investment advisors who vote proxies on behalf of investor clients to consider and evaluate any response from companies to proxy advice before submitting votes. That ***could*** cause significant delays in the already constricted proxy voting process. It also ***could*** jeopardize the independence of proxy advice as proxy advisory firms ***may*** feel pressure to tilt voting recommendations in favor of management more often, to avoid critical comments from companies that ***could*** draw out the voting process and expose the firms to costly threats of litigation.” (Emphasis added).

[28] *Id*. at note 23.

[29] In fact, the proposal describes the benefits of eliminating the engagement policies as accruing predominately to proxy advisors. *See id*. at 42-46. Notably, the costs are expected to fall on others, including investors. *See id*. at 46-47.

[30] *See id*. at 24 (Question 6, asking if the Commission should reconsider the Adviser Robo-Voting Guidance).

[31] *Id*. at 14-18, 22.

[32] *Id*. at 14-18.

[33] *See id*. at 14, note 27.

[34] *See* "Best Practice Principles Group for Shareholder Voting Research Leading Global Shareholder Voting Research & Analysis Providers Commit to New Governance & Oversight Structure in Independently Reviewed Updated 2019 Principles" (July 22, 2019), https://bppgrp.info/bpp-group-launches-new-2019-best-practice-principles-for-shareholder-voting-research-analysis/.

[35] *See* Annual Report 2021, Independent Oversight Committee of the Best Practice Principles for Providers of Shareholder Voting Research & Analysis (hereinafter "Industry Committee Report"), https://bppgrp.info/wp-content/uploads/2021/07/2021-AR-Independent-Oversight-Committee-for-The-BPP-Group-1.pdf.

[36] *Id.* at 11 ("The clear intent of founders was that the Committee be fully independent of Signatories in its judgments, though candidates would be selected in part based on the presumption that they acknowledge the importance of the industry and its duties to investor clients. While the Signatories themselves made final selections of members to serve on the founding Committee, the IOC named a Nominations Subcommittee at its 11 May 2021 meeting to begin reviewing changes to the appointments process.")

[37] *See id.* at 29 (table showing that Glass Lewis & Co., LLC and Institutional Shareholder Services Inc. each fund 26.25% of the committee's budget).

[38] There are many instances in which self-regulatory organizations are recognized by the Commission, but these organizations—such as the exchanges—are also subject to direct oversight by the Commission. To the extent that fully self-regulatory organizations have meaningful influence over their members, these organizations often draw their authority from the market forces that provide a benefit to members policing one another. For example, membership in a professional organization can confer status if the organization is known for holding its members to certain standards. However, the market for proxy advisors in the United States is small and highly concentrated. *See* Proposal at 36, note 106 and associated text. Accordingly, it is not at all clear whether those forces are strong enough to incentivize self-policing.

[39] Final Rules, at 131.

[40] Proposal, at 28.

[41] *See id.*, note 79. This footnote references seven comment letters published between January 31, 2020 and February 7, 2020. The Final Rules *were released on July 22, 2020*. *See* Final Rules, at 247.

[42] *See* Final Rules, at 132 ("Although we acknowledge commenters' concerns around the potential for heightened litigation risk associated with the proposed changes to Rule 14a-9, we reiterate that Rule 14a-9 is grounded in materiality, and amending the rule to include updated examples of potentially misleading disclosure, depending on the facts and circumstances, in no way changes its application or scope. The amendment to Rule 14a-9 does not broaden the concept of materiality or create a new cause of action, as some have suggested.") (This section of the Final Rules cites to several of the same comment letters that the proposal now cites to say that a misperception exists about heightened liability.)

[43] *See* Proposal, at 46 ("Lastly, we do not expect the proposed deletion of paragraph (e) to the Note to Rule 14a-9 *to generate any significant benefits other than avoiding any misperception* that the 2020 Final Rules' addition of that paragraph purported to determine or alter the law governing Rule 14a-9's application and scope, including its application to statements of opinion. Notwithstanding this proposed deletion, a PVAB may still be subject to liability under Rule 14a-9, depending on the facts and circumstances, for a materially misleading statement or omission of fact, including with regard to its methodology, sources of information or conflicts of interest. Thus, we expect that this proposed amendment would not have any significant economic effect." (Emphasis added)).

[44] *Id.*, at 51.

[45] *See id.* (Stating that this type of exemption would "differ[] from existing law" and "may generate additional uncertainty and litigation.")

[46] My criticism of this rulemaking does not extend to the work of the SEC staff, who have worked hard to find support for and draft this rulemaking. I appreciate their work and extensive background in this area. My concern lies with the Commission's policy choice in pursuing such a dramatic change to so recently adopted Commission rules.