Speech

Speech at the Council of Institutional Investors' ("CII") Conference

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I. Introduction

Thank you for inviting me to speak today, at CII's Spring 2020 Conference. Since I assumed office eighteen months ago, I believe I have had more meetings with CII and its members than any other group. I have appreciated these candid exchanges of ideas, and they have influenced my thinking about many issues before the Commission. I am happy to continue our dialogue.

As you all know, there is a lot going on in our markets—especially with the continually evolving news concerning the Coronavirus. While the SEC is, of course, actively monitoring market developments, our staff remains focused on our core mission and the day-to-day work that goes into protecting investors, maintaining fair, orderly, and efficient markets, and promoting capital formation. So, today I will discuss a number of matters that relate to a topic which is inextricably linked to our mission: the proxy process. Before I go further, I will of course remind you: *My views and remarks are my own and do not necessarily represent those of the SEC or other Commissioners*.

A lot has happened since Chairman Clayton announced that the Commission would engage in a comprehensive, retrospective review of the SEC rules that govern the proxy system.[1] The Commission has clarified and reaffirmed key aspects of investment advisers' fiduciary duty,[2] including as it relates to voting proxies and utilizing the services of proxy voting advice businesses.[3] Additionally, the Commission reaffirmed its longstanding interpretation that, in general, voting advice provided by these businesses fits within the definition of "solicitation."[4] Keeping in mind how useful proxy voting advice businesses' services can be to their voting customers, the Commission also proposed new amendments to the exemptions from the Exchange Act proxy solicitation rules, which are tailored to these businesses' voting advisory services and take into account current market practices.[5] Finally, the Commission proposed updated eligibility criteria for shareholders to submit proposals to be included in a company's proxy materials.[6]

Many of you have submitted comments on these matters and visited me in person, communicating strong and, in some cases, divergent views. I thank you for this feedback. Having read through many letters commenting on our proposed rulemakings, it is clear that many commenters took significant time to think through our proposed policy frameworks and to articulate specific, practical input about the way one or the other proposal could affect current business and market practices. Some commenters even took the additional step of offering alternative suggestions that they believe could achieve the Commission's policy goals. This is incredibly helpful to me and to

the SEC staff, who have devoted countless hours to improving the proxy process for all investors. I believe this type of feedback from interested market participants will help us refine and enhance our policy-making approach.

II. Proxy Voting Advice Proposal

A. Company Review of Voting Advice

One area where this type of input has made a strong impression on me is in the context of the Proxy Voting Advice rulemaking.[7] The Commission release proposes to include a period during which all soliciting parties would have an opportunity to review and provide feedback to a proxy voting advice business on its voting advice, prior to it being distributed to the business's clients.[8] The proposal contemplates that this time period for review would vary, depending on when the issuer files its proxy statement, aiming to provide an incentive for companies to file their materials earlier than required.[9] As discussed in the proposal, this pre-review period is intended to (1) improve the accuracy of the voting advice *before* it is utilized by investors and (2) improve the total mix of information available to investors when they make voting decisions.

Based on feedback from many commenters who utilize the services of proxy voting advice businesses, I understand that there is concern that these days devoted to issuer pre-review could disrupt current voting practices. Specifically, some commenters have expressed worry that these changes could decrease the time available for their own review of the proxy voting advice.

I take this feedback seriously, and I am certainly open to considering other ways to accomplish the policy goals of improving the total mix of information available to the marketplace and enhancing fairness and transparency in the voting process. One idea offered by commenters is to provide a *contemporaneous* review period for companies, wherein a proxy voting advice business would (1) send its report to the issuer at the same time it distributes the report to its clients and then (2) notify its clients if the issuer raises objections to the report within a short time period (*e.g.*, some have suggested two days).

This is an alternative I am thinking about, and I thank commenters for suggesting it. In particular, I am interested in how such a construct might work in light of certain voting practices of proxy voting advice business clients. As the release notes, the most heavily utilized voting advice businesses offer the related services of pre-populating their clients' electronic ballots with voting recommendations and *automatically submitting* them for counting.[10] Do these "set-it-and-forget-it" mechanisms tie clients' votes to the proxy voting advice businesses' recommendations? If so, would a concurrent review period for companies come too late to allow information generated by the review period to be considered by investors? More generally, I ask whether these ex-ante "set-it-and-forget-it" mechanisms are well understood by the ultimate investors and whether, particularly in idiosyncratic and contested matters, they are consistent with the duties undertaken by an investment adviser.

The Commission's proposal includes, as an addition or reasonable alternative to the proposed requirements, the concept of introducing a speed bump: a time period during which the proxy voting advice business would have to disable any *automatic* submission features, in order to be eligible for the relevant exemptions.[11] Some commenters provided input on this aspect of the proposal, and I am considering whether this may be a way to address at least some of the concerns I raised.

B. Conflicts of Interest

Another area of the release I have been considering is the proposed conflicts of interest disclosure. The proposal states: "Proxy voting advice businesses engage in activities or have relationships that could affect the objectivity or reliability of their advice, which may need to be disclosed in order for their clients to assess the impact and materiality of any actual or potential conflicts of interest with respect to a voting recommendation."[12] A few examples of conflicts were provided, such as corporate consulting and certain material relationships, but, as the release noted, this was not intended to be an exhaustive list.

Through the comment process, I have discovered that there may be others. In particular, I recently spoke about information shared with me that proxy voting advice businesses rely on a subset of their own clients to develop

their off-the-shelf voting guidelines and, in some cases, specific recommendations.[13] On first impression, this makes sense—the voting advice businesses are hired by the clients, so why shouldn't the advice reflect clients' strategies or preferences?

However, it raises some questions. Are some clients more involved than others—both generally and on specific matters? Do certain clients of proxy voting advice businesses that are unusually vocal with respect to certain types of recommendations have a greater ability to preview, provide input, or influence the development of those recommendations for clients *generally*? If so, do other clients, particularly those who only subscribe to off-the-shelf advice, understand this possibility? Or do they perceive the proxy voting advice business as wholly objective and independent?

As I have done before, I question the premise that all clients of proxy voting advice businesses have the *same* interests when it comes to voting outcomes.[14] Asset managers have all sorts of different strategies when it comes to managing the assets in their clients' portfolios. Does it not logically follow that distinct shareholders could have varying interests in proxy voting that may lead them rationally to desire different outcomes from the same company's proxy contest, transformative transaction, contested shareholder proposal, or even director election?

To be clear, I am not expressing opposition to the way any proxy voting advice business has formulated its voting advice or the way any clients have relied on that advice. I do believe, however, there should be greater transparency about how this voting advice is developed, who is involved in the process, and what that may mean for the interests of fund investors. Consumers of proxy voting advice would benefit from such transparency as they consider how to utilize the voting advice and, in the case of funds, how they describe their use of such advice to their investors.[15]

III. More Work Ahead

I believe the Commission's proposal on proxy voting advice makes headway in updating our rule set to account for the increased importance of proxy voting advice businesses in the marketplace today. But, even if adopted, I do not believe our work would be close to complete. In fact, over the last year or so, I have come to see how much more the Commission could do to improve the proxy process, beyond either of our current rule proposals.

A. Examining Investment Advisers' Voting Practices

For example, even if proxy voting advice businesses were to disclose all of their material conflicts of interest, and even if they were to provide their clients with easy and timely access to issuers' views on their recommendations, there may be market participants who ignore that information and outsource their voting decisions to these businesses, without appropriate diligence or oversight. To the extent any of these market participants are registered investment advisers under the SEC's jurisdiction, I believe it is important that we identify any such actors and assess how they believe they are fulfilling their fiduciary duty to their clients.[16] I hope to see more SEC examinations focusing on this area.

B. Group Behavior

Another area of activity I believe the Commission should assess is whether shareholders, acting through voting advice businesses, are operating as "groups" in our securities markets for purposes of our beneficial ownership rules. Let me pause here and note that there is absolutely nothing wrong with shareholders working together to engage with a company's management about their views regarding the company. However, Congress determined long ago that under certain circumstances, if the beneficial owners of a significant percentage of the company's shares are acting together to control or influence control of the company, all investors should be aware of that collective action. More specifically, Exchange Act Section 13(d) was enacted by Congress to require disclosures of certain information by any person, or, importantly, a group of persons, who acquire beneficial ownership of more than five percent of a publicly-traded company's equity securities. The Commission, in turn, adopted Regulation 13D which, among other things, requires the filing of a Schedule 13D, with information about who these

shareholders in the group are, their interests in the company's securities, the purpose of the transaction, and any plans or proposals relating to certain significant action.[17] For example, the filing of the Schedule 13D may disclose or signal to the public that a significant group of shareholders want the company to pursue a change of control, an acquisition, a divestment, or another transformative transaction.

I am concerned that some market participants have the mistaken impression that they can evade the disclosures required by our beneficial ownership rules by coordinating their voting decisions on important matters presented at a shareholder meeting through a proxy voting advice business. This impression is flatly and unassailably wrong. The Commission has been clear that when two or more persons agree to act together for the purpose of voting their shares, a group has been formed for purposes of our beneficial ownership rules.[18] It does not matter whether that coordination is occurring directly among these persons or indirectly through an intermediary such as a single investor, law firm, or proxy voting advice business that acts as a hub.

If coordination in voting activity is carried out through a voting advice business, the market does not get the benefits of the disclosure Regulation 13D requires. Failure to file a required Schedule 13D could mask many different kinds of activity that would affect a company, its shareholders, and the broader market. For example, this could add credence to the worries of those discussing economic theories of "common ownership."[19] I worry most that this could particularly disadvantage retail shareholders, who would be entirely in the dark about the level of coordinated influence others in the market may be exerting.

I hope to see the Commission explore whether further action is needed to ensure Regulation 13D is not circumvented in this context, and I am interested to hear from market participants about their views on this topic.

C. Plumbing

Another area deserving of attention is our proxy plumbing. One point I have seen raised in letters commenting on both of the Commission's current rule proposals is: Why is the SEC prioritizing proxy voting advice and shareholder proposals when there is the "much simpler" issue of proxy plumbing to tackle? Don't be fooled. Proxy plumbing is anything but simple. It is an area of our market where many different types of actors are intertwined and entrenched in their current roles and have been for several decades.

1. Proxy Plumbing (An Oversimplified Introduction)

Let me start with an oversimplified explanation of how our system currently works. After a company determines its annual meeting record date, the company (or its transfer agent) must distribute proxy materials to all of the company's shareholders. The company can easily find the names and addresses of its *registered* shareholders in its stock register, but the vast majority of investors in U.S. companies are "beneficial owners," who do *not* hold their shares directly. Rather, they hold through an intermediary nominee, like a bank or broker (the "intermediary"). So, the company must contact DTC to obtain a list of the intermediaries and send search cards to each one, requesting information about how many of the intermediary's customers are beneficial owners of the company's shares. Having that information, the company can provide each intermediary with that number of proxy materials to pass along.

Often times, however, these intermediaries loan out their customers' shares, which potentially transfers the customers' voting rights to someone else. Intermediaries may dig into the question of which beneficial owner should have the right to vote a given share of stock—the lending beneficial owner, or the borrower?—or they may request duplicate materials be sent to both. Interestingly, the intermediary may have a financial incentive to ask for the greater number of materials to be provided, because it might be compensated *per package distributed* to its customers. Of course, giving out more than one set of voting instructions per share may result in the intermediary casting more votes than its customers are actually entitled to. But, since the outcome of an election is rarely so close that someone would demand a recount, I worry that this possibility may not be enough of a concern to outweigh the intermediary's financial incentive or motivate it to go through the inconvenience of reconciling its customers' voting rights.

So, the company (and ultimately the company's shareholders) will pay for the intermediaries to (1) distribute voting materials for the company's annual meeting to customers and (2) collect those customers' voting instructions, so that each intermediary can cast its votes in accordance with its customers' preferences. The company will have *no knowledge or control* over whether the intermediaries have provided an accurate beneficial owner count or distributed the materials only to those people who actually have the voting entitlement. But the company (and its shareholders) must foot the bill, whatever the cost may be. There will be no alternative, because rates for reimbursing the intermediaries for these services have been effectively set by the rules of self-regulatory organizations, and the rules have not been changed since 2013.[20]

Even a company that's willing to shoulder some of this work by itself to save costs will be limited in what it can do. The company will have limited access to the identity and contact information of many of its beneficial owners. Some of these beneficial owners are "Objecting Beneficial Owners" under our OBO/NOBO framework, having opted (or been defaulted by their intermediaries) to have their identities shielded from the company. While a list of *Non-Objecting* Beneficial Owner customers should be available from any given intermediary (for a fee), such a list would only include names, securities positions, and snail mail contact information. Moreover, while the company could, in theory, mail its annual report to each NOBO, it would still have to rely on the intermediary to distribute proxy statements and voting instruction forms, since current SEC rules and the realities of omnibus share ownership preclude the company from sending them proxy materials directly.

2. Consensus in Finger-Pointing

Many have decried the complexity, inefficiency, and archaic nature of this system.[21] But, I have yet to hear anyone describe an easy path toward improvement. In fact, as I see it, every one of the market participants involved would have to sacrifice something in order for the system to undergo meaningful change.

Consider the topic of end-to-end voting confirmation. There is broad consensus amongst market participants that investors and our markets would benefit from votes being confirmed in each election.[22] If a shareholder votes, shouldn't he or she know that those votes were, in fact, counted? But, there is no consensus about who should foot the bill (or give up the right to send a bill) to make this happen. And, with so many players involved in the system, it is easy for each to point a finger at someone else.

For example, some have suggested that issuers should pay for this service.[23] But, it's not clear to me how this would improve upon the status quo. As I described, companies currently fund the voting process, but have little or no control over how beneficial owners are identified, how materials are distributed, and how votes are counted. Would adding to their list of expenses improve the system's transparency or introduce new competition into the market for proxy services?

Many have opined that meaningful change in our system can only come by reforming the OBO/NOBO practices, which allow some shareholders to keep their identities and contact information hidden from the companies in which they invest.[24] I understand some reasons why shareowners would want the privacy of being an OBO, but I am trying to learn what disclosure is provided to them about what it means to be an OBO—and the degree to which they are presented with optionality—when making that decision. I also want to better understand whether being an OBO introduces extra costs into this system. If it does, should that privacy come with a price tag, since ultimately it may be borne by other shareholders?

Others have pointed to the nominee intermediaries. Brokers and banks at times can benefit from maintaining their customers' anonymity rather than allowing issuers to send materials directly to them. Should these intermediaries then have to ensure that only one vote per share is counted, and that the votes they cast correctly reflect the preferences of their customers who rightly hold the voting entitlement on the record date?

3. Moving Forward

These questions are not simple, but they are important. I understand that many in the private sector, including representatives from CII, have been working together to provide input on several aspects of our proxy plumbing,

including potential solutions for end-to-end-voting confirmation and OBO/NOBO. Thank you for your engagement in these difficult discussions.

I am not naïve enough to believe they will result in widespread consensus on any particular solution. However, I believe this group engagement could aid SEC staff's understanding of the status quo and highlight areas of disagreement that can help us study options for change. The goal of any changes should not be to favor any particular type of market participant. Rather, they should be designed to serve the interests of the ultimate retail investors who have invested in our public companies.

D. Universal Proxy

Finally, as I have been assessing our voting system from the perspective of how to best serve retail investors, I have come to believe the Commission should consider adopting a universal proxy rule. I was not a member of the Commission at the time of the 2016 proposal,[25] but I understand that commenters provided robust feedback, including suggestions for improvement. Additionally, we have had the benefit of receiving further input in the context of the 2018 Roundtable. There seems to be growing consensus that a universal proxy rule could provide benefits to everyone involved in a proxy contest, most importantly, the investors being solicited. Of course, my door is always open to anyone who would like to discuss a potential rulemaking. That said, it would be especially helpful if issuers and investors (both those who solicit and those who are solicited) could work together to advise me, the other Commissioners, and the staff on the best path forward.

IV. Conclusion

Again, I appreciate your time and graciousness in inviting me to speak. Now that I have set out many areas for your consideration, I look forward to learning your perspective on each.

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[1] *See* Chairman Jay Clayton, "Statement Announcing SEC Staff Roundtable on the Proxy Process" (July 30, 2018), https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process.

[2] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (June 5, 2019).

[3] *See* Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5325 (Aug. 21, 2019) ("Voting Guidance").

[4] *See* Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules, Release No. 34-86721 (Aug. 21, 2019).

[5] *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-87457 (Nov. 5, 2019) ("Voting Advice Proposal").

[6] *See* Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Release No. 34-87458 (Nov. 5, 2019).

[7] Voting Advice Proposal, *supra* note 5.

[8] *Id.* at 44.

[9] *Id.* at 45–46.

[10] Voting Advice Proposal, at 9.

[11] *Id*. at 66 and 116.

[12] *Id*. at 27.

[13] *See* Commissioner Elad L. Roisman, "Myths and Realities: Modernizing the Proxy Rules," (Jan. 30, 2020); *see also* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors (Oct. 15, 2019) ("Those recommendations are not the view of a disembodied advisor wielding power independently of its clients. Rather, proxy advisor voting recommendations are the product of many years of engagement with institutional shareholders and issuers alike. Through this process, proxy advisors have received and taken into account many viewpoints on corporate governance issues, policies and feedback received from prior and active situations. This process has ensured that proxy advisors' recommendations reflect the views they receive from institutional investors, whose interests they serve.")

[14] *See* Commissioner Elad L. Roisman, "Keynote Remarks: ICI Mutual Funds and Investment Management Conference," (Mar. 18, 2019).

[15] *See* Voting Guidance, *supra* note 3, at 19.

[16] The Commission recently reiterated that proxy voting is a service that investment advisers can provide to clients—but like other services the adviser undertakes on a client's behalf, it is subject to a fiduciary duty and must be carried out in the client's best interest. *See* Voting Guidance, *supra* note 3, at 3. An adviser must not place its own interests (*e.g.*, gathering assets) ahead of the interests of the client (*e.g.*, realizing an attractive return on a risk-adjusted—and/or other preference—basis). *See*, *e.g.*, *In the Matter of Intech Investment Management, LLC and David E. Hurley*, Rel. No. 2872 (May 7, 2009), https://www.sec.gov/news/press/2009/2009-105.htm. Regardless of how the Commission may decide to address proxy voting advice issues, I think investment advisers should reexamine their voting practices and ensure that they still reflect the interests of each of their clients.

[17] 17 C.F.R. § 240.13d-1, 240.13d-101.

[18] 17 C.F.R. § 240.13d-5.

[19] *See*, *e.g.*, Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, Boston University Law Review, Vol. 99:1151 (2019).

[20] *See*, *e.g.*, NYSE Rule 451.90; *see also* Order Granting Approval to Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name, and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform, Release No. 34-70720 (Oct. 18, 2013).

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

[22] *See*, *e.g.*, Recommendation of the SEC Investor Advisory Committee (IAC) on Proxy Plumbing (Sept. 5, 2019), https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-proxy-plumbing.pdf ("IAC Plumbing Recommendation").

[23] *Id.* at 7 ("In the first instance, costs and responsibility for confirmations should fall on companies.")

[24] *See*, *e.g.*, Letter from Anne Robinson, Managing Director and General Counsel, The Vanguard Group, Inc. (Sept. 20, 2019); Letter from Barbara Novick, Vice Chairman, and Janey Ahn, Managing Director, Legal & Compliance, BlackRock, Inc. (Nov. 12, 2019).

[25] *See* Universal Proxy Proposed Rule, Release No. 34-79164 (Oct. 26, 2016).