PROXY PROCESS AND RULES: EXAMINING CURRENT PRACTICES AND POTENTIAL CHANGES

S. Hrg. 115–455

PROXY PROCESS AND RULES: EXAMINING CURRENT PRACTICES AND POTENTIAL CHANGES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING SEVERAL ASPECTS OF THE CORPORATE PROXY VOTING SYSTEM, INCLUDING THE ROLE OF PROXY ADVISORY FIRMS, THE SHAREHOLDER PROPOSAL PROCESS AND RETAIL SHAREHOLDER PARTICIPATION

DECEMBER 6, 2018

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

S. HRG. 115–455

PROXY PROCESS AND RULES: EXAMINING CURRENT PRACTICES AND POTENTIAL CHANGES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING SEVERAL ASPECTS OF THE CORPORATE PROXY VOTING SYSTEM, INCLUDING THE ROLE OF PROXY ADVISORY FIRMS, THE SHAREHOLDER PROPOSAL PROCESS AND RETAIL SHAREHOLDER PARTICIPATION

DECEMBER 6, 2018

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: https://www.govinfo.gov/

U.S. GOVERNMENT PUBLISHING OFFICE

34–527 PDF WASHINGTON : 2019

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

MIKE CRAPO, Idaho, *Chairman*

RICHARD C. SHELBY, Alabama
BOB CORKER, Tennessee
PATRICK J. TOOMEY, Pennsylvania
DEAN HELLER, Nevada
TIM SCOTT, South Carolina
BEN SASSE, Nebraska
TOM COTTON, Arkansas
MIKE ROUNDS, South Dakota
DAVID PERDUE, Georgia
THOM TILLIS, North Carolina
JOHN KENNEDY, Louisiana
JERRY MORAN, Kansas

SHERROD BROWN, Ohio
JACK REED, Rhode Island
ROBERT MENENDEZ, New Jersey
JON TESTER, Montana
MARK R. WARNER, Virginia
ELIZABETH WARREN, Massachusetts
HEIDI HEITKAMP, North Dakota
JOE DONNELLY, Indiana
BRIAN SCHATZ, Hawaii
CHRIS VAN HOLLEN, Maryland
CATHERINE CORTEZ MASTO, Nevada
DOUG JONES, Alabama

GREGG RICHARD, *Staff Director*
MARK POWDEN, *Democratic Staff Director*

JONATHAN GOULD, *Deputy Chief Counsel*
JEN DECI, *Professional Staff Member*

LAURA SWANSON, *Democratic Deputy Staff Director*
ELISHA TUKU, *Democratic Chief Counsel*

DAWN RATLIFF, *Chief Clerk*
CAMERON RICKER, *Deputy Clerk*
JAMES GUILIANO, *Hearing Clerk*
SHELVIN SIMMONS, *IT Director*
JIM CROWELL, *Editor*

C O N T E N T S

THURSDAY, DECEMBER 6, 2018

PROXY PROCESS AND RULES: EXAMINING CURRENT PRACTICES AND POTENTIAL CHANGES

THURSDAY, DECEMBER 6, 2018

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. The Committee will come to order.

Today's hearing will focus on several aspects of our proxy voting system, including the role of proxy advisory firms, the shareholder proposal process and retail shareholder participation.

As SEC Chairman Clayton noted earlier this year, shareholder engagement is a hallmark of our public capital markets, and the proxy process is a fundamental component of that engagement. I commend the SEC for its ongoing attention to this issue, including its recent staff roundtable on the proxy process and rules, and I encourage them to move forward with their reform efforts.

Many of these rules have not been examined for decades. In that time, there have been a number of changes to the proxy environment, including the growing influence of proxy advisory firms and fund managers on voting outcomes and, more generally, corporate behavior.

There has also been a rise in the number and substantive scope of proposals pursuing an environmental, social, or political agenda. Many of these proposals have little or nothing to do with a company's financial performance or shareholder value, but companies and investment advisors alike, nevertheless, devote time and resources to evaluate these proposals, often relying upon proxy advisory firms or other consultants to assist them and reduce their costs.

It is time to reexamine the standards for inclusion of these proposals as well as the need for fiduciaries to vote all proxies, on all issues in light of the proliferation of environmental, social, or political proposals, and the rise of diversified passive funds.

Chairman Clayton has also expressed concerns that the voices of long-term retail investors may be underrepresented or selectively represented in corporate governance.

According to an SEC staff estimate, retail investors own roughly two-thirds of Russell 1000 companies, often through mutual funds or pensions. But it is not always clear whether the proxy rules promote the long-term financial interests of those retail investors, many of whose interests are expressed through intermediaries.

Last week, John Bogle, the creator of the index fund, warned that if historical trends continue, a handful of giant institutional investors will one day hold voting control of virtually every large U.S. corporation.

With this level of concentration and intermediation, it is even more important that the proxy voting process and voting decisions of fiduciaries reflect the clear economic interests of the retail investors on whose behalf these institutional investors engage.

I look forward to hearing the views of our witnesses on these and other proxy-related issues, and I thank them for their willingness to appear here today.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman.

Thanks to our three witnesses.

All too often, we see corporate boards and executives focus on short-term profits instead of long-term investments in their companies and their workers.

We saw very painful and clear evidence of that this week. General Motors announced it would lay off 14,000 workers and close five plants. Ohio, the number two GM State in the country for decades, no longer, if GM continues with this, will assemble any of their vehicles in Ohio.

The Chevy Cruze plant in Lordstown is slated to lose jobs. In the last 2 years, GM has laid off nearly 3,000 workers at the Lordstown plant. This most recent decision suggests they will lay off another 1,500, the whole workforce. The decision is devastating for the Mahoning Valley, a three-county area with about 500,000 people.

Meanwhile, GM has spent more than $10 billion on stock buybacks—$10 billion on stock buybacks since 2015, double what it expects to save from the cuts and the plant closings. Lordstown workers and their families and the supply chain company workers and the owners of many of those companies are angry.

The President claimed last year's Republican tax bill would mean more money in workers' paychecks, but instead, we have seen these stock buybacks explode this year to a record $894 billion. Executives claim these record buybacks are supposed to reward shareholders. They do not seem interested, however, in hearing from shareholders when they raise concerns.

The bad corporate decisionmaking does not stop with GM and with buybacks and layoffs. Marriott announced on Friday, it had a data beach between 2014 and 2016, affecting 500 million customers. It only discovered that in September of 2018.

Cyber breaches are so common now that it is routine for Wall Street analysts to estimate the stock price hit, companies will take in the week after they have announced a breach. Then it is business as usual. It does not even matter that companies cannot secure their customers' personal information.

These are just the most recent examples of corporate mismanagement and abuse of workers and customers.

Excessive executive compensation packages, abuses and scandals that can wreck customers' financial lives like we have seen at Wells Fargo, price gouging for vital prescription drugs like we have seen at the company Mr. Gallagher works for, it is clear these corporations are not making good decisions for their companies, for their customers, for their workers. It is why we should foster more shareholder engagement, not less.

But that is not how corporate lobbyists and special interests see it. The Wall Street business model does not see workers like those in Lordstown as vital to their company. They see them as cost to be minimized.

But, incredibly, we are here today to discuss how to make it even more difficult for shareholders to hold management accountable. Several bills introduced this Congress undermine shareholder oversight of the companies they own. These measures would deny all but the largest shareholders the right to submit proposal for a vote, requiring investors to own billions of dollars of stock to be eligible to submit a shareholder proposal.

Current rules permit small shareholders to submit proposals, but apparently, folks in this town want to stack the deck even more. Every day, there is another attempt to stack it even further against Main Street, against small-time investors.

This hearing will consider proposals that make it harder for institutional investors to have timely access to research and analysis from proxy advisory firms that the investors have hired. These proposals would give corporate interests access to this information before the public retirement systems, investment fund managers, and foundations who manage money for hardworking Americans. And what is fair about that?

You will hear about errors and inaccuracies in those reports, but what it really amounts to is an effort to make an independent analysis less so. That is just the wrong answer.

Shareholders of all sizes deserve to have every tool available to hold executives accountable, forcing them to think beyond their short-term self-interest and manage for the long term. Companies and shareholders and workers and other stakeholders all benefit when the system promotes fairness and communications and trust.

Mr. Chairman, before I finish, I wanted to note that Senator Reed must leave for another committee. I want to take a moment to thank him for his work on a bipartisan bill on proxy advisors and ask him to describe his bill briefly, and, Mr. Chairman, I appreciate your willingness to do that.

Jack.

Chairman CRAPO. Thank you.

Senator REED. Thank you, Mr. Chairman, and thank you, Ranking Member Brown, not only for holding this hearing, but for giving me an opportunity to speak, as I must go to another Armed Services committee meeting.

Investors have been clear that continued access to proxy advisory firms is critical. Given this, it is important that proxy advisory firms are appropriately regulated and held accountable.

That is why I am very pleased that Senators Perdue, Jones, Tillis, Heitkamp, and Kennedy have joined me in introducing S. 3614, the Corporate Governance Fairness Act, which preserves the vital role played by proxy advisory firms, but also holds these firms accountable to investors.

In addition to the broad bipartisan support here for the legislation, a wide range of stakeholders, including the Consumer Federation of America, SEC Investor Advisory Committee member John Coates of Harvard Law School, the New York Stock Exchange, and the Society for Corporate Governance also support the Corporate Governance Fairness Act.

I thank all the stakeholders for this, particularly my colleagues, Senators, Perdue, Heitkamp, Tillis, Jones, and Kennedy. Thank you all.

And, again, I thank the Chairman for his graciousness. Thank you very much.

Chairman CRAPO. Thank you, Senator Reed and Senator Brown.

And also, again, thank you to our witnesses for agreeing to be here and to share with us your expertise.

Our witnesses today—and we will have them speak in the order I introduce them—are the Honorable Daniel M. Gallagher, Chief Legal Officer of Mylan N.V. and former Commissioner, U.S. Securities and Exchange Commission; Mr. Michael Garland, Assistant Comptroller, Corporate Governance and Responsible Investment in the Office of the Comptroller of New York City; and Mr. Thomas Quaadman, Executive Vice President of the U.S. Chamber Center for Capital Markets Competitiveness.

And to each of our witnesses, as you know, your testimony has been entered into the record, and we encourage you to pay attention to the clock, so that you do not go over 5 minutes in your oral presentations, so that we will have opportunities for the Senators. And I again remind our Senators, they have a 5-minute clock too.

With that, Mr. Gallagher, you may proceed.

STATEMENT OF DANIEL M. GALLAGHER, CHIEF LEGAL OFFICER, MYLAN N.V. AND FORMER COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. GALLAGHER. Thank you, Chairman Crapo.

Chairman Crapo, Ranking Member Brown, and Members of the Committee, it is an honor to be here today to discuss the critically important issue of corporate proxy voting.

During my tenure as an SEC commissioner, few issues generated as much discussion and controversy as the various facets of the proxy voting system, and I was recognized for actively engaging on those issues. That is why I was invited here today to share my views on the three issues identified in the invitation letter and how the SEC can, or should, respond to these issues.

This is very important, as more than 3 years after I left the Commission, these issues have become even more pronounced from so-called "proxy plumbing issues" to the concerns about the role of proxy advisory firms. The intensity of the debates is evidence of the importance of these issues to U.S. investors, corporations, policymakers, and ultimately the U.S. economy.

Many of these issues are exactly the types of technical matters that independent agencies like the SEC were created to address, subject to congressional oversight, and I am happy to tell you that the current Commission is exceptionally well situated to fix many of the problems related to proxy voting.

Chairman Clayton has proven to be a strong principled leader of the agency, and his fellow commissioners have deep expertise in the proxy voting area. The relevant senior staff, including Division of Investment Management Director, Dalia Blass, and Division of Corporation Finance Director, Bill Hinman, are incredibly capable leaders and experts on proxy voting issues.

Despite the SEC's expertise in this area, however, the Commission is operating within a very antiquated statutory framework when it comes to proxy voting.

Accordingly, and certainly with respect to certain high-impact issues such as the ever increasing importance of proxy advisory firms, the time is right for meaningful congressional attention. And so I am very happy that this Committee is focusing its limited time on these issues.

Indeed, I will note at the outset that Members of this Committee are working on bipartisan legislative efforts to address the proxy advisory firm concerns, and the House is similarly focused on these issues and has passed bipartisan bills that provide solutions to many critical proxy voting problems.

I hope that effective legislation can, if needed, be enacted in the near future.

Thank you again for inviting me here today, and I look forward to answering any questions you may have.

Chairman Crapo. Thank you very much, Mr. Gallagher.

Mr. Garland.

STATEMENT OF MICHAEL GARLAND, ASSISTANT COMPTROLLER FOR CORPORATE GOVERNANCE AND RESPONSIBLE INVESTMENT, OFFICE OF THE NEW YORK CITY COMPTROLLER SCOTT STRINGER

Mr. GARLAND. Thank you, Member Brown and Members of the Committee.

I am the Assistant Comptroller for Corporate Governance and Responsible Investment in the Office of New York City Comptroller Scott Stringer. Comptroller Stringer serves as a trustee to four of the five New York City public pension funds and as the investment advisor and custodian to all five, which collectively have more than $200 billion in assets under management. These five independent pension funds provide retirement security to more than 700,000 of the city's active and retired teachers, police, firefighter, and other employees. It is an honor to be invited to provide this Committee with our perspective on important matters of shareowner responsibility.

Because of our long investment horizon and largely indexed investment strategy, we cannot readily sell shares in a company at which we have concerns. In those instances, the most cost-effective way we can protect and create long-term shareowner value is to be an active owner by exercising our rights, our legal rights, as shareowners. Therefore, we actively vote our proxies at each portfolio company and actively engage our portfolio companies mainly through shareowner proposals and dialogue ensuing from those efforts.

Our capacity to fulfill these fiduciary responsibilities to our beneficiaries relies heavily on the timely receipt of expert independent proxy research and our longstanding ability to submit shareowner proposals.

The unfounded suggestion from critics is that when it comes to voting proxies, which are considered plan assets under relevant fiduciary law, sophisticated institutional investors whose job it is to manage billions of dollars of investment capital are like lemmings, blindly following the recommendations of proxy advisors in a proxy vote decision-making.

This does a great disservice, and I want to disabuse Committee Members of the notion that the argument of undue proxy advisor influence has merit. Although I assess the largest proxy advisory firm, recommended voting against say-on-pay proposals at 12.3 percent of the Russell 3000 in 2018, only 2.4 percent of those companies received less than majority support on their say-owner proposals.

For the year ending June 30, 2018, our office cast 71,000 individual ballots at 7,000 shareowner meetings in 84 markets around the world. In the U.S. market, every ballot item is individually reviewed and voted on by our experienced staff. All votes are cast according to our own guidelines, irrespective of the proxy advisors' recommendations. Our ability to apply our own guideline rests, in large part, on a timely receipt of the expert research we receive from our proxy advisors, which presently included both Glass Lewis and ISS.

Because different companies present key information in different ways and places, we rely on our advisors to pull information to a consistent format that enables quick reference to comparable data.

As an example of our independence, while the New York City funds voted against say-on-pay at 25.4 percent of our U.S. portfolio companies for the year ending June 30, 2018, ISS only recommended against say-on-pay at 16.7 percent of those companies.

In our view, additional regulation of proxy advisors would likely increase our cost and delay our receipt of research, with no clear benefit to our process.

Our funds have filed more than 1,000 shareowner proposals, almost certainly more than any other institutional investor in the world, and our proposals have led to significant market changes that benefit long-term shareholders.

For example, largely in response to the Boardroom Accountability Project launched by Comptroller Stringer and the New York City funds in 2014, roughly 540 companies, including 70 percent of the S&P 500, now have proxy access bylaws, up from about six companies when the project was launched. Proxy access allows shareowners to nominate one or more directors to a company's board using the company's proxy and ballot.

A July 2015 study by economic researchers at the SEC analyzed the public launch of the Boardroom Accountability Project and found that 0.5 percent average increase in shareowner value at the first 75 firms that received proxy access shareowner proposals from the New York City funds.

In response to a shareowner proposal in 2013, we successfully negotiated an enhancement to Wells Fargo's clawback policy. Those changes enabled the Wells Fargo board to announce in September 2016 that it would recoup $60 million from two senior executives in order to hold them financially accountable for the fake account scandal that has caused significant financial and reputational harm to the bank.

But large institutional investors do not have a monopoly on good ideas. In our view, shareowners of any size should have the opportunity to use the shareowner proposal process.

Additionally, our track record shown in our proposals to prohibit workplace discrimination based on sexual orientation and gender identity has shown that there are good reasons for not increasing the resubmission thresholds. It can take many years to build investor support for a shareowner proposal.

In summary, we believe critics of shareowner proposal rights and proxy advisors are seeking to remedy problems that do not exist.

Thank you again for the opportunity to testify today. I look forward to your questions.

Chairman CRAPO. Thank you, Mr. Garland.

Mr. Quaadman.

STATEMENT OF THOMAS QUAADMAN, EXECUTIVE VICE PRESIDENT, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

Mr. QUAADMAN. Thank you, Chairman Crapo, Ranking Member Brown, Members of the Committee. We appreciate this Committee's continued focus on removing obstacles that prevent businesses from growing from small to large.

The 20-year decline of public companies has brought economic consequence. The 2012 Kaufmann Institute study found that between 1996 and 2010, 2.2 million jobs were created by businesses that went public. Additionally, in the 1980s and 1990s, mainstream investors directly benefited from IPOs. Today, companies go public at a much later stage, shutting those mainstream investors out from that wealth creation. Additionally, if companies do not go public, they are not creating jobs.

This hearing presents a spotlight on three important issues: the lack of oversight of the proxy advisory duopoly, distraction of boards and inefficient use of company assets, and disenfranchisement of retail investors.

We know many of the issues around proxy advisory firms, yet in response to a recent Banking Committee letter and the recent SEC Roundtable, ISS claims to be a fiduciary, yet disclaims any fiduciary obligations. Proxy advice should correlate to the fiduciary duty of their clients.

ISS and Glass Lewis have conflicts. Both a consulting business and activist investor ownership are well known, yet they both share a common conflict of interest in that neither discloses to the public if a shareholder proponent is a client of an advisory firm.

Indeed, a recent ACCS study found that 139 supplementary filings between 2016 and early 2018 disputed proxy advisory inaccuracies as well as mistakes. That is a 2 percent error rate that we know of on proxy advice. A 2-percent error rate in any fiduciary duty is unacceptable. Clients, in other words, are not getting the total mix of accurate, useful information needed to decide how to vote.

Opponents of proxy advisory oversight raised cost concerns, but what about flawed decisionmaking processes that reduce returns for retirees, families, or individuals who are looking to secure their livelihood?

We appreciate the introduction of the Bipartisan Corporate Governance Fairness Act. We support a transparent process in the development and dispensation of proxy advice.

We think this legislation could be changed in a couple of ways. One, proxy advisory firms should certify recommendations are based on material accurate information. Two, they should disclose conflicts. Three, they should disclose to the public if a shareholder is a proponent. We look forward to working with the sponsors of that bill.

There are additional problems as well. Zombie proposals—those shareholder proposals that are repetitively introduced, yet have lower declining support—harm the shareholder process. Those proposal constitute one-third of shareholder proposals, yet 90 percent of them are continually rejected. Proxy advisory firms supported those proposals. ISS supports 79 percent of them, allowing them to be propped up. This creates a waste of assets, company assets, and distraction for both boards and investors.

At some point in time, the will of the majority must mean something. The resubmission thresholds were first introduced in 1954 and have not been updated. The investor base is the mirror image of what it was in 1954. We think that the 1997 Arthur Levitt proposal to raise these thresholds to 6, 15, and 30 percent should be a basis for reform.

We also have four individual investors known as “gadfly investors” that submit 30 to 40 percent of the shareholder proposals in the S&P 250. Ninety-one percent of those proposals fail, and it is unclear if those investors actually own the shares or if at times are actually acting as a front for third-party entities.

We believe that if a shareholder issues a proposal, there should be disclosure and verification of ownership as well as an articulation of the interest that they are supporting.

Finally, retail shareholders are being disenfranchised. Direct retail share ownership today constitutes 32 percent of shares, yet only 28 percent of that block is actually voted, in contrast to 91 percent of institutional investors. We do not have a level playing field.

We think that innovative new technologies, such as client-directed voting, virtual meetings, and blockchain can be a remedy for this.

We can no longer wait on these issues. Our international competitors are making their public capital markets more efficient. It is time for the SEC and Congress to act to promote competition and preserve U.S. competitiveness in a global economy.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Mr. Quaadman.

I will start with you, Mr. Garland, in the questions. As I understood your testimony, you do not just take the proxy advisor's advice, per se. You actually take their research, look at their recommendations, and then go in and do a due diligence analysis of their recommendations. Is that correct?

Mr. GARLAND. That is correct, Mr. Chairman.

I would not say that we do a due diligence analysis of their recommendations. Our obligation is to implement the guidelines that were approved by our boards of trustees, and our guidelines are different than the guidelines from the proxy advisors.

Let me give you an example. Some issue can be fairly binary. There may be a proposal for an independent board chairman. ISS or Glass Lewis may recommend against that proposal because they believe that the company has another mechanism in place. For example, lead independent director, that is adequate. Under our guidelines, we will always support a vote for an independent board chairman.

Chairman CRAPO. So on these guidelines you are talking about, are they specific to each corporation?

Mr. GARLAND. No. They are a set of governance principles that inform our view of value and what we think is our best long-term interest. As long-term owners, we articulate a philosophy about boards of directors, executive compensation, and also many of the matters that may be subject to vote through shareowner proposals.

Chairman CRAPO. So are those guidelines consistent across all corporations that you own?

Mr. GARLAND. We maintain two sets of guidelines. We have a set for U.S. companies, which are available on our website, and we have a set for non-U.S. companies because the items subject to vote vary by market, and all of our domestic guidelines and all of our global proxy votes are disclosed on our website, so that our participants and beneficiaries and our portfolio companies can review them.

Chairman CRAPO. OK. One last quick question for you, and that is, do these guidelines all focus on increasing shareholder value and the value of the corporation, or are these guidelines also focusing on environmental, social, or political objectives?

Mr. GARLAND. Well, the proxy vote relevant under State law for us, we consider that to be a fiduciary asset. So the guidelines are constructed in a manner, and they are recommended to the board in a manner solely to maximize long-term shareowner value.

Many of the issues which often are referred to as social or political, we believe they are directly on long-term shareowner value.

So when we cast a proxy vote, we are voting because we believe that is in our long-term best financial interest.

Chairman CRAPO. All right. Thank you.

I would love to go into that much further with all three of you, but I want to shift to Mr. Quaadman and Mr. Gallagher. A question for both of you, and then I will probably be out of time. Please pay attention to my clock because I do not want to violate it for my colleagues here.

But the SEC staff recently withdrew staff guidance dating from 2004 on the use of proxy advisory firms and held an important roundtable to get to our next steps. I am interested in learning more about the tradeoff between long-term investing and a social agenda and a fiduciary's calculation and how retail investors should be involved.

I know that is a question that requires a long answer, but I would like you to each take about 45 seconds to respond to me on that.

Mr. GALLAGHER. Well, thank you, Senator, for the question.

I think it is a critically important issue that you have teed up for this hearing about retail participation because I think we have lost, and the trend toward institutional ownership of shares and sort of disintermediated retail participation in the United States, we have lost the retail voice, which sometimes thinks very differently than the collective institutional asset manager.

The SEC was right to tee this up. I think Jay Clayton, the Chairman of the SEC, has been a real voice for what he calls the "Main Street investor," and I think the Roundtable started the dialogue in a very meaningful way.

Chairman CRAPO. Well, thank you.

I would request further thoughts of yours on this as we proceed in analyzing this.

Mr. Quaadman.

Mr. QUAADMAN. Mr. Chairman, both the Roundtable and withdrawal of those two letters were important steps forward. We are very concerned because both—first off, environmental, social, and political shareholder proposals make up over 50 percent of those that are submitted, yet almost none of them pass.

ISS and Glass Lewis have recently started both ESG ratings that is going to put even more fuel behind that. Those proposals are not directly linked to economic return. So we think that increased SEC oversight over proxy advice is very important, particularly as ESG is beginning to gain more of a foothold.

Chairman CRAPO. Thank you, Mr. Quaadman.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

Mr. Garland, briefly describe how shareholder proposals help to hold management accountable, briefly.

Mr. GARLAND. Yes. Thank you, Senator Brown.

For us, it is a critical tool for holding management accountable. I think a good example would be—and in your opening remarks and in my remarks, we referenced Wells Fargo. In 2013, we filed a shareowner proposal at Wells Fargo asking them to strengthen their clawback policy.

We filed it at Wells Fargo and a number of other banks. We were concerned that in the banking industry, no senior executives were held financially accountable in the wake of the financial crisis. We think accountability is key for setting a proper tone at the top for responsible business practices and ethical conduct. If you are not held accountable, you essentially can have the incentive to look the other way if you are benefiting from the misconduct of those below you.

So when the fake account scandal happened at Wells Fargo, we sent a letter to the Compensation Committee and said, "You now have this new policy," and the policy that they adopted that we negotiated with them, it has three key components. And these are all requested in the proposal.

First, there is a misconduct trigger that the board has the authority to clawback compensation in the vent of misconduct.

Second, what we call the "up-the-ladder provision," that you can be held financially accountable for misconduct for a supervisory failure. So, in the case of Wells Fargo, for example, the fact that John Stumpf may not himself have engaged in misconduct, but the board had the authority to clawback compensation because he was held ultimately accountable, that is a way of ensuring accountability and eliminating the perverse incentive to look the other way.

And the final prong is public disclosure so that investors have the ability to monitor enforcement of that policy.

And one last point on accountability, the fact that most companies in the U.S. market now have annual elections for directors, which is a fundamental accountability mechanism, and have majority voting in direct elections is largely the result of successful shareowner proposals.

Senator BROWN. And you can certainly make the case. This is a yes or no here. You can make the case, certainly, that those proposals adopted by Wells Fargo made a big difference in the clawback, correct?

Mr. GARLAND. Yes. And it is really the way the process is supposed to work. It never went to a vote. It is an invitation to engage. You submit the proposal. They called us up, and then we had a very productive negotiation.

Senator BROWN. In your testimony, Mr. Garland, you mentioned the risks if regulation creates obstacles for investors to use proxy advisors. How would additional regulatory burdens on proxy advisors limit investors' ability to hold company management accountable?

Mr. GARLAND. I think that some of the proposals from critics seek to insert the issuers in between investors and the advisors who we hire. These are our advisors, and I think that could compromise their independence. We rely on the independent expert research they provide to us.

There is also a big concern about timing. The volume of proxy voting during proxy season is tremendous. We only have a very little time to apply our guidelines from the time that the company files its proxy until it has its annual meeting. Our process generally does not start until we receive the research from the proxy advisors, and we are not looking at the recommendations. But just seeing issues like dilution or diversity on board, looking at the hedging and pledging policies of the company, there are all kinds of metrics in those reports that we need to interpret our own guideline.

Senator BROWN. Thank you.

Let me ask one last question and preferably a simple yes or no, and I will start with you, Mr. Quaadman. If a shareholder is concerned that a company is price gouging, say, for a critical medicine and it could affect long-term value in the company's reputation, should we take tools away from that shareholder to hold management accountable?

Mr. Quaadman, let us start with you. Yes or no, if you would.

Mr. QUAADMAN. Shareholders should keep companies accountable, and that is a dialogue that companies should have with their shareholders, but when that process is perverted for political or social gains, that is where it becomes a problem.

Mr. GALLAGHER. Mr. Garland.

Mr. GARLAND. I think that drug pricing can create reputational risk for companies, which is why we have called on companies like Merck filing the EpiPen price increase to elevate oversight of drug pricing to the board.

Senator BROWN. I was not sure what you meant on political or social, but maybe we can get back to that if we have time.

Mr. Gallagher, your comments on that?

Mr. GALLAGHER. Senator, Thank you for the question.

I am never one to say we should take a voice away from investors. I think the proposals that are being discussed today, in particular, 14a–8, amendments all have to do with what is a meaningful ownership position such that the voice should be heard.

And I do not personally believe that any of the discussions we have had about potential amendments are of the type that would diminish the voice of shareholders, such that we have heard.

Senator BROWN. So you would say that we should not take away tools from the shareholders to hold them accountable?

Mr. GALLAGHER. I would say that, but I would also say that the proposals I have seen would not do that. So I do not think that is what is at stake with some of the modest amendments that have been discussed with 14a–8.

Chairman CRAPO. Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman.

Thank you, gentlemen, for coming.

I am here to learn. You know more than I do. I am going to ask you a few questions. I only have 5 minutes. I would just like you to answer them straight up and talk to me like I am a tenth grader, OK?

It has been alleged that proxy advisory firms have conflicts. Do they? If so, how?

Mr. Gallagher, we will start with you.

Mr. GALLAGHER. Senator, when I walked into the Commission as commissioner in 2011, I did not know what a proxy advisory firm was. But I will tell you, it was the number one issue presented to me by the business community, by others in the corporate governance world. I am sure you can share some of the same stories in your offices.

The stories I have heard, there are facts and——

Senator KENNEDY. Do they have conflict?

Mr. GALLAGHER. They do. They absolutely do.

Senator KENNEDY. Then tell me about them.

Mr. GALLAGHER. There are two types of conflicts. One is a pretty obvious one that I actually do not view as that problematic. That is when you have a proxy advisory firm providing consulting services to the issuers that they are providing recommendations on.

That is disclosed and knowable, and in fact, everyone, I believe, assumes that there is that conflict in place.

Senator KENNEDY. So the proxy advisory firm is giving advice to the institutional investor——

Mr. GALLAGHER. Right.

Senator KENNEDY.——but it is doing work for the company about whom it is giving advice?

Mr. GALLAGHER. Absolutely correct, Senator.

Senator KENNEDY. OK.

Mr. GALLAGHER. And then there is a second, which I think is a more insidious potential conflict, which is that the proxy advisory firm is providing advice to institutional investors, some of whom pay more in fees than others to the proxy advisory firm, given the volume of votes, given the volume of assets under management.

Senator KENNEDY. What is wrong with that?

Mr. GALLAGHER. Well, there might be an outsized influence by one institutional investor over another in that context, where they might pressure a proxy advisory firm.

Senator KENNEDY. OK.

Mr. Garland.

Mr. GARLAND. The practice of selling services to companies they provide ratings on does constitute a conflict of interest.

Senator KENNEDY. How so?

Mr. GARLAND. Mr. Gallagher's point with respect to one of the advisors, ISS, there is a conflict that we as clients I think have a responsibility to oversee.

Mr. Quaadman referenced another conflict with respect to the other advisor, which is owned by a large Canadian pension fund. In my view, that ownership does not present a conflict. That really is an alignment of interests.

Senator KENNEDY. OK.

Mr. Quaadman.

Mr. QUAADMAN. Yeah. Let me just add a couple more. One is actually an example with Glass Lewis. We have sent letters to both SEC and DOL with McGraw-Hill and also Canadian Pacific, where on day one, a dissident director slate is proposed. Day two, Ontario Teachers' Pension fund announces its support. Day three, Glass Lewis announces it support for that dissident director slate. That is at least the appearance of a conflict, and we think that that should be looked at.

Number two, as I mentioned in my opening statement, both firms do not disclose if a shareholder proponent of a proposal or a dissident director slate is also a client to the advisory firm.

Senator KENNEDY. OK.

Mr. QUAADMAN. Now, that is important because you can think of the economic return.

Senator KENNEDY. Let me stop you a second——

Mr. QUAADMAN. Yep.

Senator KENNEDY.——because I have only got 2 minutes.

Mr. QUAADMAN. Sure.

Senator KENNEDY. Each of you are King for a Day. You can do whatever you want. Politics be damned, OK? What, if anything, would you do with respect to regulation of proxy advisory firms?

Mr. Quaadman.

Mr. QUAADMAN. Disclosure of conflicts, open and transparent process for advice, there is a level playing field, and everybody knows exactly what the advice is. And that there is no hidden third parties trying to push an agenda.

Senator KENNEDY. Mr. Garland.

Mr. GARLAND. I think transparency with respect to conflicts with the issuers, which is currently disclosed to clients.

Senator KENNEDY. OK.

Mr. GALLAGHER. Senator, thanks for the question.

I could not agree more with Mr. Quaadman. It is about transparency and accountability too. In any situation in which you have a fiduciary duty running from a principal to an agent and you cut that off by inserting a third party who arguably does or does not have a fiduciary duty, you have a problem. We see that in certain areas.

Senator KENNEDY. But you do not think they have a fiduciary duty now? It is uncertain?

Mr. GALLAGHER. Well, based on the letter that ISS sent you that I read, I am a little confused. They clearly have a registered investment advisor in their holding group. There had been some debate about where the recommendations came out of.

Senator KENNEDY. Would the three of you support creating an explicit fiduciary responsibility?

Mr. GALLAGHER. Yes, Senator.

Mr. QUAADMAN. Yes.

Senator KENNEDY. OK. Mr. Garland.

Mr. GARLAND. Yes.

Senator KENNEDY. OK.

Is there anything in Mr. Reed's bill that should not be there or that is there—that should be there or should not be there?

Mr. GALLAGHER. Senator, I think the bill is great for a bunch of purposes. The biggest one is the recognition of the need for action. I think it is pretty bare bones. It is very simple.

Senator KENNEDY. OK.

Mr. GALLAGHER. I think there are a few things that we could tweak.

Senator KENNEDY. OK. Briefly, gentlemen. I am sorry to cut you off. I just do not want to run over. Quickly, either of you?

Mr. QUAADMAN. It is an important first step, and I mentioned in my opening statement, I think there are three or four things that could be added that I do not think are that problematic that can help disclosure and a level playing field.

Senator KENNEDY. Mr. Garland.

Mr. GARLAND. We do not oppose the bill.

I think our concern is that it is enforced in a manner to protect the investor clients rather the issuers who are being rated.

Senator KENNEDY. All right. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you, Mr. Chair.

And let me follow-up on the line of questioning by my colleague, Senator Kennedy.

And thank you, all three, for being here as well. This is very instrumental for learning as we move forward.

Do you think disclosing a conflict is enough to address the conflict? I am going to ask all three of you.

Mr. GALLAGHER. Thanks for the question, Senator.

That is the premise of pretty much the entirety of the U.S. securities laws. The disclosure, and in a clear way without fraud or misrepresentation, should be enough for an investor to make proper investing decisions, including in this context, the voting decision.

So, yes, I think disclosure goes a long, long way.

Senator CORTEZ MASTO. Mr. Garland.

Mr. GARLAND. As a matter of practice, we generally support disclosure as a tool to address conflicts of interest.

The conflict under discussion here is a little less relevant to us because it speaks to compromising a recommendation on which we do not rely.

Mr. QUAADMAN. I agree with Mr. Gallagher's comments.

I would also say, too, that in the current system that we have, advisory firms do not have to disclose all their conflicts, nor do their clients have to ask about those conflicts.

The other thing that disclosure does is it also forces the clients of the advisory firm to manage those conflicts and ensure that they are meeting the fiduciary duties that they have to their investors.

Senator CORTEZ MASTO. Do we need to be concerned that proxy advisory firms recommend votes in favor of management recommendations more often than an alternative view? Are we concerned at that at all?

Mr. GALLAGHER. Senator, I think to the extent that that would imply that they are not doing the hard work, that that number is skewed in some way, then yes. I mean, one of the main criticisms of the firms is that the quality of the work is not up to snuff. So to the extent it is 90 percent or more and folks view that that not to be appropriate, I think that is a question in and of itself, separate from issuer concerns that they are getting matters wrong and misinterpreting in a way that is negative for the management proposal.

Senator CORTEZ MASTO. OK.

Anyone else?

Mr. QUAADMAN. One other thing I would just add with that, if you take a look at ISS, they have 180 employees to evaluate, analyze, and make recommendations on 250,000 issues. Think about that workload. They are not properly resourced to do their job, and that should be something that is also troubling because at the end of the day, if investors are not getting decision-useful information, they are not meeting their fiduciary obligations.

Senator CORTEZ MASTO. Do you think that the proxy advisors need to be regulated by the SEC?

Mr. GALLAGHER. Senator, I am not a real regulatory type; by nature, more free market. But I think we have reached the point in this industry where, yes, there needs to be a role for the SEC because, as I mentioned in response to Senator Kennedy's question, whenever you have a fiduciary duty flowing and you have that from the institutional investor to the beneficiary, but you put in the middle of that a third party that may or may not have a duty, I think things get twisted in a way. And I think that you need someone, an entity like the SEC, to come in and regulate that flow, much like Congress did with credit rating agencies in 2000.

Senator CORTEZ MASTO. Thank you.

Gentlemen, yes or no. I am running out of time as well.

Mr. GARLAND. No, I think it depends what that regulation looks like.

Senator CORTEZ MASTO. OK.

Mr. GARLAND. If it flows our access to information, compromises their independence, and poses significant cost incentives, we would oppose it.

Mr. QUAADMAN. We provided ISS with a proposal in 2010 for an open and transparent system and for disclosure, and the response that we got, because they were being sold at the time, was "We are not interested. It is going to cost too much money."

We are 4 years past SLB 20 being introduced by the SEC. We thought that was an important step forward, but clearly, there are still flaws in the system that need to be addressed. So there needs to be a heightened level of oversight.

Senator CORTEZ MASTO. OK. And then, Mr. Garland, I am curious. You talked about the guidelines that New York State has set in the Comptroller's Office with Senator Crapo, and I know there is an association of State comptrollers. Those guidelines that you have identified, is that a best practice across the country for the State comptrollers, or is that something you, just New York State, has identified?

Mr. GARLAND. We have maintained our own proxy voting guidelines since 1987 when we took back voting control from external investment managers. We believe that having guidelines is best practice, and we would like to believe that our view on particular issues reflects best practice.

Senator CORTEZ MASTO. OK. Are you aware of the association, national comptrollers, and do they address this issue as well as a national level?

Mr. GARLAND. I am aware of a national—many of my principal's peers with respect to his responsibilities fall with State treasurers as opposed to comptrollers, and we work with many of the public funds in the country. Many of our peers maintain guidelines and vote proxies in a very similar manner, as we do.

Senator CORTEZ MASTO. Right.

I notice my time is up. Thank you very much. I appreciate the conversation today.

Chairman CRAPO. Thank you.

Senator Toomey.

Senator TOOMEY. Thanks very much, Mr. Chairman, and thanks to all of our witnesses for joining us.

You know, I just want to start off with a quick observation about really a fantastic development over recent decades for small and retail investors, which is really the collapse in the fee structure.

I mean, the cost for a middle-income individual or family to invest in our capital markets is a tiny fraction of what it once was, and this is a fantastic development for retail investors. It gives access to huge categories of asset classes. It gives access to those classes that just was not there before, and I sure want to make sure that we are not doing anything to impede not only that development, and then I will put in a plug for a constituent, Vanguard, that has clearly been at the forefront of this. It is stunning how the kinds of services that they provide that are virtually free. It is just amazing, and it is great for investors.

But not everybody is as big as Vanguard, and one of the things that concerns me is the cost of some of these shareholder vote requirements for a money manager that may not have the resources of a Vanguard, for instance.

I think there may be some disagreement among the panelists over whether or not and the extent to which there in fact are a lot of shareholder proposals that are not fundamentally about the operation of the company.

And so let me pose a question to each of you briefly. Is it your view that there are frequently shareholder proposals that are really about a social or environmental or political or cultural issue and not fundamentally about the return to shareholders of the company?

Starting with Mr. Gallagher, does that actually happen?

Mr. GALLAGHER. Well, thank you for the question, Senator Toomey, and I can give you an example of another one of your constituents, which is PNC Bank.

I remember when I was on the Commission one day commuting down from my home in Baltimore, reading the Wall Street Journal, and seeing reported in the Journal that PNC had gotten a shareholder proposal on the environmental impact of its lending activity. I also was reading that the SEC had decided against PNC in that regard, which was news to me. So you can imagine how happy I was when I walked into that office that morning——

Senator TOOMEY. Yeah.

Mr. GALLAGHER.——which gave me a very good insight into the internal staff process, and we can talk about that later, if you like.

Senator TOOMEY. So do I infer your answer is yes——

Mr. GALLAGHER. Absolutely.

Senator TOOMEY.——that this happens?

Mr. GALLAGHER. Yes.

Senator TOOMEY. This does happen?

Mr. GALLAGHER. It does.

Senator TOOMEY. Mr. Garland.

Mr. GARLAND. No. We are often criticized for filing proposals that I think some would characterize as political or social in nature.

One example that we are very proud of dates back to 1992 when we filed a proposal to prohibit workplace discrimination at a company—Cracker Barrel—that fired some employees because they were gay, and so we have since then, we and other investors, filed hundreds of proposals to prohibit workplace discrimination based on sexual orientation and gender identity.

Senator TOOMEY. Is not that illegal? Is not there a law against that?

Mr. GARLAND. In some States. It is not uniformly illegal, and there is research from Credit Suisse that says they value diversity and also the notion that you want to cast a wide net to get the most talent. We think there is a direct correlation to value.

Senator TOOMEY. OK. Mr. Quaadman, do you think these, the answer to my question?

Mr. QUAADMAN. Yes, Senator Toomey.

Manhattan Institute and even ISS data shows that over 50 percent of shareholder proposals now are of a nature that are environment, social, or political.

Senator TOOMEY. And not fundamental to the well-being of the company or returns to shareholder?

Mr. QUAADMAN. Correct.

Senator TOOMEY. Fifty-percent. Over 50?

Mr. QUAADMAN. Over 50 percent, and almost none of them ever pass.

In fact, there was a study by the University of Tennessee in 2015 that looked at public pension plans that had a very overt political, social, or environmental bent with what they do, shareholder proposals. They had the lowest rate of return, creating tens of billions of dollars of unfunded liabilities for State taxes.

Senator TOOMEY. I am running out of time, but very quickly, if you do not blindly follow the proxy advisors, would it not be potentially extremely expensive to systematically evaluate all of the proposals for all of the companies if your business model requires that you be invested in many, many companies?

Mr. QUAADMAN. One of the issues that was addressed in SLB 20—and I think it needs to be maybe highlighted a little further—was that it specifically stated that institutional investors do not have to vote on every single issue. So that they should only do so if they feel it is material.

Senator TOOMEY. Mr. Gallagher, I think you wanted to add something.

Mr. GALLAGHER. Yeah. I just wanted to jump on that because I was at the Commission at the time of SLB 20. That was unfortunately revolutionary at the time. The interpretation of the '03 rule that gave rise to the purported obligation to vote every share, every vote, we dispelled that myth, and we thought that would set folks free and give you a zero-cost ability to say we are not going to vote on this one, we are going to pre-direct our voting in accordance with management, in accordance with the New York Comptroller. You could pick whoever you want. We have not seen the uptake, though, on that, which is a shame.

Senator TOOMEY. All right. Thank you.

I see I have run out of time. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Jones.

Senator JONES. Thank you, Mr. Chairman, and thank you for this important hearing.

Thank you for the witnesses to come here today.

Obviously, this is a major issue, with the thousands of proxy issues that take place every year, especially during the high season. It has gotten complicated, technical, and I think ripe for reform. And I am pleased to be part of the bipartisan group of Senators who are working to bring some—a little bit of reform to this, and I look forward to trying to continue that process.

In addition to just reform, though, one of the things I have got a concern about is just the lack of competition in this area. I firmly believe that having more competition in the marketplace on anything provides better options for investors. It also pushes best practices in this industry, push them right to the forefront.

What can be done? As I understand it, it is like two firms that dominate like 95 percent or more of this industry. What can we do or look at to maybe encourage more competition in this whole area going forward?

I will open that up to the panel.

Mr. GALLAGHER. Well, thanks for the question, Senator. I will take a stab at it.

This is the exact same issue I already referenced that Congress dealt with in 2006 with the Credit Rating Agency Reform Act, which was how do we regulate these critically important advisors that weigh in in a substantive way on the merits of a product or an issuer, which is kind of similar to proxy advisory firms. How do we do that without either regulating them out of business or creating barriers to entries such that you do not have competition? And I know Congress struggled with that at the time.

And what they came out with in the Credit Rating Agency Reform Act was a sort of low-threshold, low-touch registration requirement at the SEC that encouraged application, and then in return, you got an imprimatur that was used in a very special way throughout the securities markets.

It has not exactly panned out, 12 years later. I think you still have market domination by three big players in the rating space, but you do have 16 or 17 other registrants that came behind them that did not exist as NRSROs, so-called “NRSROs,” before that legislation came through. I think I even noticed one of them in the audience here today. So there is a tension.

Your Act, I think would be different in that just the requirement of investor advisor registration. It is a known paradigm that the SEC oversees. Whether it increases competition amongst firms, brings them in, adds too many costs, I do not know because I have not gone through that sort of cost-benefit thinking, but I did want to bring back the parallel analysis that Congress did with the credit rating agencies.

Senator JONES. Great. Thank you.

Mr. QUAADMAN. Senator Jones, 11 years ago or so, there was a firm, PGI, that tried to enter the market. A few years ago, there was another firm, Proxy Mosaic, that tried to enter the market, and they had a difficult time because of the market power of the two dominant firms.

Look, the Chamber is not a proponent of regulation, normally.

Senator JONES. Right.

Mr. QUAADMAN. But even if you take a look at what we are proposing here, if you take the direction that your bill is going in, we think that there should be some additional disclosures around that. I think that allows for the appropriate oversight of those firms, and I agree with what Mr. Gallagher was saying. This is analogous to the credit rating agencies.

Look, this is a situation that we have, and until there is another entrant that is going to be successful, we have to have this level of oversight for a level playing field.

Senator JONES. Great.

Mr. GARLAND. Senator Jones, I share your underlying concern about the lack of competition. Investors would be better served if there were more advisors, rather than less. I think the fact that the bill has a carve-out for smaller is appropriate.

Senator JONES. Right.

Mr. GARLAND. And the challenge is the barriers to entry. For clients like us, our portfolio is so massive that it is very hard for a new entrant to be able to provide us with the tools we need to vote across in 84 markets around the world.

Senator JONES. All right. Thank you.

Real quick, as my time is running out, this whole proxy process is incredibly complicated. I did not think I could find anything more complicated than trying to navigate between the Dirksen, Russell, and Hart Senate Office Buildings, but this process certainly is.

Are there takeaways from the Roundtable about maybe helping the whole process? Are there things that can be done to streamline that? And we have only got a little bit of time left.

Mr. GALLAGHER. Senator, I will take a 5-second opportunity just to plug technology. I think technology can resolve a lot of the issues that were highlighted in the SEC Roundtable, whether it be the plumbing issues for sure, whether it be voting issues.

I do not want to speak for Michael here, but I think the institutional investors would love more transparency and accountability that you can get through technology.

Senator JONES. Great.

Mr. QUAADMAN. Same. I think particularly when you take a look at retail shareholders who have been disenfranchised, if you start to take a look at things like blockchain and client-directed voting, that will allow them to be more of a participant, and I think that is also going to help make the system more efficient.

Senator JONES. Great. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman.

Thank you all for being here.

I want to start with Mr. Quaadman. I was struck—I was going to start with Mr. Garland, but I was struck with something you said about the process being perverted for social and political goals. And I just kind of want to flesh this out because I think here is what I worry about. I assume you are a conservative. I am a known liberal, and so we may disagree on any number of issues, including climate change or LGBTQ or whatever.

But the question that I have for you, is a climate change proxy proposal by definition, in your view, a sort of social, political goal? Because it seems to me that when you are talking about publicly traded companies that may have stranded assets or publicly traded companies that may have power plants or real estate assets in coastal areas that get flooded, it is perfectly reasonable for shareholders to say, "Hey, hold on a second. We need to account for this better. We need to have a more robust climate strategy." And so the question is, in a case like that, is that a social-political end, or are you referring to something else?

Mr. QUAADMAN. So if you take a look at climate change, if you take a look at what EEI has done, they have actually created standards for disclosure for utilities for how they can provide that information out to their investors and to other stakeholders who are interested in that information.

When you take a look at ESG disclosures and ESG movement, that is used for a variety of different stakeholders. It is used for investors. It is used for employees, consumers, and even vendor management.

So what there is right now is there is a struggle as to how we are going to deal with that. When you take a look at environmental, social, and political shareholder proposals, they make up over 50 percent of the shareholder proposal.

Senator SCHATZ. Hold on, but let us slow down.

Mr. QUAADMAN. Yeah.

Senator SCHATZ. What is an environmental, social, or political proposal? Because it seems to me that basically you are defining it as anything that you do not like that does not service short-termism, that is not advancing your clients' and your institution's interest, which is fine, but I am having a hard time understanding what it is that you mean by that except the stuff that I do not want companies to have to deal with.

And one more point here, it seems to me that under the law, shareholders have a perfect right to make that determination themselves about what is in the interest of the company as part owners of the company. So can you clarify what you mean by social-political? Because the Cracker Barrel example is a really good example. In '92, that may have been viewed as a sort of political question, but now it is clearly a reputational and shareholder question, and so who gets to make that determination? In my view, not the regulators. In my view, not the legislative branch. In my view, the shareholders themselves.

Mr. QUAADMAN. So directors have a fiduciary responsibility to long-term management and strategies of——

Senator SCHATZ. I know that.

Mr. QUAADMAN.——preservations of assets, correct? So if you take a look at, let us say, political and lobbying spending disclosures in, let us say, the defense aerospace industry, right? There are studies that have found that that type of lobbying and those expenditures are critical to the profitability of that company, yet those proposals fail by over 80 percent.

So the question is, over the course of time, what we are saying here is, particularly with the resubmission thresholds, if these proposals keep on coming up, yet 80 percent of the shareholders have said it is not material and the SEC has said that is not material, at some point in time, it should just be given a time-out if you reform the resubmission thresholds.

So I think it is a matter of also looking. Are those proposals pushing a political agenda, or are they actually tied to——

Senator SCHATZ. And who decides that?

Mr. QUAADMAN. Are they tied to the profitability of a company? But I think the other question is, are we also——

Senator SCHATZ. Hold on. Hold on. Hold on.

Mr. QUAADMAN. Yeah. Go ahead.

Senator SCHATZ. You are restating the claim over and over again, and I would like you to define what it is that is a political agenda other than stuff you do not want companies to have to talk about because, in my view, just because a company continually refuses to deal with the stranded assets problem, just because a company refuses to deal with the fact that they may have resources in the coastal areas that they are denying are in peril or not insured properly or subject to severe weather, just because you think they should continue to ignore that does not mean that they ought to.

I am going to finish with Mr. Garland because I would like you to respond to the exchange that we had, with my remaining seconds, please.

Mr. GARLAND. Thank you, Senator Schatz.

I appreciate that you raised climate change as an issue, which is something that our boards have been spending a lot of time on.

In 2015, Mark Carney, the Governor of the Bank of England and the Chair of the Financial Stability Board, said climate change presents a systemic risk to the global financial system, and so he and the G20 tasked the Financial Stability Board with coming up with a framework to help markets price and understand risks within individual companies.

And what Carney said is climate change is the—if you are familiar with the tragedy of the commons, as externalities with respect to environmental issues, climate change is a tragedy of the horizons. The most devastating consequences are not going to affect today's decision-makers. It is going to be the next generation.

Given our time horizon, our time horizon is measured in generations. So we have to take those risks very seriously, and climate change does present risks and opportunities, the risks both of transition to a low-carbon economy and the physical impacts from severe weather and rising ocean levels.

So our boards last year, we hired a consultant to help us integrate climate change into our investment strategy and asset allocation and provide a set of recommendations, which we are now moving on.

In September of this year, Comptroller Stringer and Mayor de Blasio and other trustees announced a commitment to double our investment from $2 billion to $4 billion in clean energy solutions.

Senator SCHATZ. Thank you.

Chairman CRAPO. Thank you.

Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman, and thank all of you for what you are doing here today. As Senator Jones said, it is a complicated area. It is an area that I think may be able to use some reform, but I am struck the way the sort of tables are turned here.

Mr. Gallagher, you mentioned you were from Baltimore. I am glad to have you as a Maryland constituent. As you know, in Baltimore, we also have a firm, T. Rowe Price, and I have a letter here from T. Rowe Price strongly opposing this legislation.

I just want to read to you part of what they say here. They are responding both as an institutional client of a proxy advisory firm as well as a corporate issuer covered by proxy advisors. So they are seeing this from both perspectives, and in this letter, they write:

> We make our own voting decisions using the independent research provided to us by our proxy advisor as one factor, among many, used to inform our firm's voting positions. The House bill, which I understand you support, Congressman Duffy's bill, would diminish the independence of that research and therefore its value to us as a client.

I have a simple question. Why are you supporting the bill that diminishes the value of that information, and why did we want regulation that says to T. Rowe Price, we need this regulation because we know what is better for you, T. Rowe Price? We need for you to have all this regulation so that you can make the right decisions for your investors.

I just find that this whole thing has been turned on its head.

Mr. GALLAGHER. Well, Senator, thank you for the question. I am happy to be your constituent.

I am not here to support the Duffy bill or any bill, quite frankly.

Senator VAN HOLLEN. OK.

Mr. GALLAGHER. That is for you guys to decide. I am an old SEC staffer who is used to taking congressional direction and running with it, so whatever Congress chooses to do is best.

In this context, I would disagree with T. Rowe. I do not believe the Duffy bill would do what they say. I do not think the Duffy bill would do a lot of what its opponents would say.

As I understand the Duffy bill and I have studied it over the years—I have not looked at it in a while, but it is, as we talked earlier about the Credit Rating Agency Reform Act of '06, predicated based upon that body of statute, which was meant to be incremental, which was meant to bring in oversight.

Senator, I do not come to Congress and ask for regulation and legislation a lot. I am more of a free-market guy, but I will tell you this is one spot, like I said earlier, that I heard more about these issues, the proxy advisory issue in particular, than anything else as an SEC commissioner, from sheepish executives and others who would not want to come and do this today, who would not want to raise their profile, who whisper. And you hear the anecdotes, and it drove me to think that we need to do something in this space. And if we are going to do it, why not do it in a way where we leverage something that Congress found to be pro-competitive? Because I am really worried about the concern of new entrants and everything else.

Senator VAN HOLLEN. Right.

I would just suggest that adding this additional layer of requirement and requirements on people who are providing advice actually will raise the cost of new entrants.

Mr. GALLAGHER. Yeah.

Senator VAN HOLLEN. It will make it more difficult——

Mr. GALLAGHER. Right, right.

Senator VAN HOLLEN.——for people to compete.

I appreciate—I believe that you were in favor of the Duffy bill, but here is the thing. So you are saying here is a major firm, T. Rowe Price——

Mr. GALLAGHER. Right.

Senator VAN HOLLEN.——that essentially is saying this legislation is telling us that Congress wants to put in these protections. We do not want the protections. They will actually undermine the value of the information we are receiving.

Mr. GALLAGHER. Right.

Senator VAN HOLLEN. And I do find it a strange world where we are equating that to credit rating agencies. I mean, there may be some of the reforms registering. That is fine. Credit rating agencies have a model where they collect information from consumers without the support of—without the consent of consumers.

These are big firms, in many cases, and small firms who are choosing, who believe it in their economic interest——

Mr. GALLAGHER. Right.

Senator VAN HOLLEN.——to hire a proxy advisor, to give them advice. They can choose to reject the advice or accept the advice, but here we are coming along saying, "You know what? You, T. Rowe Price, do not really know what is good for you, and we are going to insist that we go through this other process"——

Mr. GALLAGHER. I hear you.

Senator VAN HOLLEN.——"and to the Chamber." What is your response to this?

Mr. QUAADMAN. Look, as I stated earlier, we do not come at this position lightly that we think that there should be regulation and oversight, but the fact of the matter is, as I said in my opening statement, as far as we can see, flawed information, from what we saw with the supplementary filings, means at the end of the day, they are not getting decision-useful information that can impact the return of the clients of T. Rowe Price.

Senator VAN HOLLEN. Yeah.

Mr. QUAADMAN. So if that return is being impacted, that is going to affect retirees, families, homeowners, and that is something that I think we need to take a cost-benefit analysis to look at.

Senator VAN HOLLEN. Look, I am with you, but the suggestion there is that T. Rowe Price does not know how to weigh the information they are getting from these proxy advisors.

I would also point out in the same letter, they say that from their perspective as a corporate issuer, because they are also subject to these proxy advisors, that we appreciate having effective ways to address factual errors and proxy advisor research reports, but in this regard as well, the proposed legislation is unnecessary, given current practices and available legal remedies. In other words, that a lot of this has to be put on a portal, right, available to review, and here we are, this bill. I am not saying this bill—the Duffy bill essentially says to T. Rowe Price, you know, "We know better than you." I just find it a strange——

Mr. QUAADMAN. I would just say quickly, Senator—I know your time is up, but I think T. Rowe and some of the other firms, as Senator Toomey said with Vanguard, they use proxy advisory reports as one data point of many to make their decisions.

The problem is you have a large group of smaller institutional investors that completely outsource their functions or their thinking to the advisory firms, and that is where the problem lies.

Senator VAN HOLLEN. I understand that. I just think, again, that risk should be borne by those firms that make that decision. If they do not like that proxy advisor, get rid of them. Do something else. Tell them you want them to do a better job. But, in this case, we are coming in and again saying that they do not know what they are doing. I just find it overly burdensome.

Chairman CRAPO. Thank you.

And I would like to thank all of our witnesses again for coming today, not only your testimony here today, but the testimony you have supplied and the advice and support and guidance that you will supply as we continue.

For Senators who wish to submit further questions for the record, those questions are due on Thursday, December 13th, and I encourage the witnesses, as I suspect you will get some additional questions, to please respond to those as promptly as you can.

Again, thank you very much for being here, and with that, the hearing is adjourned.

[Whereupon, at 11:09 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO

Today's hearing will focus on several aspects of our proxy voting system, including the role of proxy advisory firms, the shareholder proposal process and retail shareholder participation.

As SEC Chairman Clayton noted earlier this year, "Shareholder engagement is a hallmark of our public capital markets and the proxy process is a fundamental component of that engagement."

I commend the SEC for its ongoing attention to this issue, including its recent staff roundtable on the proxy process and rules, and I encourage them to move forward with their reform efforts.

Many of these rules have not been examined for decades.

In that time, there have been a number of changes to the proxy environment, including the growing influence of proxy advisory firms and fund managers on voting outcomes and, more generally, corporate behavior.

There has also been a rise in the number and substantive scope of proposals pursuing an environmental, social or political agenda.

Many of these proposals have little or nothing to do with a company's financial performance or shareholder value.

But companies and investment advisers alike nevertheless devote time and resources to evaluate these proposals, often relying upon proxy advisory firms or other consultants to assist them and reduce their costs.

It is time to re-examine the standards for inclusion of these proposals as well as the need for fiduciaries to vote all proxies on all issues in light of the proliferation of environmental, social or political proposals, and the rise of diversified passive funds.

Chairman Clayton has also expressed concerns that the 'voices of long-term retail investors may be underrepresented or selectively represented in corporate governance.'

According to an SEC staff estimate, retail investors own roughly two-thirds of Russell 1,000 companies, often through mutual funds or pensions.

But it is not always clear whether the proxy rules promote the long-term financial interests of those retail investors, many of whose interests are expressed through intermediaries.

Last week, John Bogle, the creator of the index fund, warned that "if historical trends continue, a handful of giant institutional investors will one day hold voting control of virtually every large U.S. corporation."

With this level of concentration and intermediation, it is even more important that the proxy voting process and voting decisions of fiduciaries reflect the clear economic interests of the retail investors on whose behalf these institutional investors engage.

I look forward to hearing the views of our witnesses on these and other proxy-related issues, and I thank them for their willingness to appear here today.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

Thank you, Chairman Crapo, and welcome to our witnesses.

All too often, we see corporate boards and executives focus on short-term profits, instead of long-term investments in their companies and their workers.

We saw pretty clear evidence last week.

GM announced it would lay off 14,000 workers and close five plants, including the Chevy Cruze plant in Lordstown, Ohio. In the last 2 years, GM has laid off nearly 3,000 workers at the Lordstown plant and, after this most recent decision, that number may grow to 4,500 workers who have gotten a pink slip. This decision is devastating for the Mahoning Valley.

Meanwhile, GM has spent more than 10 billion dollars on stock buybacks since 2015—more than double what it expects to save from the job cuts and plant closings. Of course, Lordstown workers and their families are angry.

The President claimed last year's Republican tax bill would mean more money in workers' paychecks. But, instead we've seen stock buybacks explode this year to a record 894 billion dollars. Executives claim these record buybacks are supposed to reward shareholders, but they don't seem interested in hearing from shareholders when they raise concerns.

And the bad corporate decisionmaking doesn't stop with GM and with buybacks and layoffs. Marriott announced on Friday that it had a data breach between 2014 and 2016, affecting 500 million customers, which it only discovered in September.

Cyber breaches are so common now that it's routine for Wall Street analysts to estimate the stock price hit companies will take in the week after they announce a breach. Then it's business as usual, and it doesn't even matter that companies can't secure their customers' personal information.

These are just the most recent examples of corporate mismanagement and abuse of workers and customers.

Excessive executive compensation packages; abuses and scandals that can wreck customers' financial lives like we've seen at Wells Fargo; price gouging for vital prescription drugs like we've seen at the company Mr. Gallagher works for—it's clear these corporations aren't making good decisions for their companies, their customers, or their workers. It's why we should foster more shareholder engagement, not less.

But, that's not how corporate lobbyists and special interests see it. The Wall Street business model doesn't see workers like those in Lordstown as vital to their companies—it sees them as a cost to be minimized.

But incredibly, we're here today to discuss how to make it even more difficult for shareholders to hold management accountable. Several bills introduced this Congress undermine shareholders' oversight of the companies they own.

Those measures would deny all but the largest shareholders the right to submit proposals for a vote, requiring investors to own billions of dollars of company stock to be eligible to submit a shareholder proposal. Current rules permit small shareholders to submit proposals, but apparently, folks in this town want to stack the deck even further against Main Street, small-time investors.

This hearing will also consider proposals that make it harder for institutional investors to have timely access to research and analysis from proxy advisory firms that the investors have hired. These proposals would give corporate interests access to this information before the public retirement systems, investment fund managers, and foundations who manage money for hardworking Americans.

You'll hear about errors and inaccuracies in those reports, but what it really amounts to is an effort to make independent analysis less so. That's also the wrong answer.

Shareholders of all sizes deserve to have every tool available to hold executives accountable—forcing them to think beyond their short-term self-interest, and manage for the long term. Companies, shareholders, workers, and other stakeholders all benefit when the system promotes fairness, communication, and trust.

Thank you, Mr. Chairman.

Testimony of

Daniel M. Gallagher
Before the
United States Senate
Committee on Banking, Housing, and
Urban Affairs

December 6, 2018

Good morning. Thank you Chairman Crapo, Ranking Member Brown, and Members of the Committee for inviting me to testify today.

My name is Dan Gallagher, and I am currently the Chief Legal Officer of Mylan N.V. From 2011 through 2015, it was my privilege to serve as a Commissioner of the SEC. I am very pleased to be here with the Committee today as you consider important matters regarding public company proxy voting issues. These are issues which I spent a lot of time considering and debating while on the Commission, and I am pleased to be here, in my personal capacity, to discuss them with you today.

In your invitation, Chairman Crapo, you asked that I address the following three issues:

(1) the role of proxy advisory firms and their involvement in the voting process, their current regulatory treatment, any views I may have, and suggestions for SEC action, if any;

(2) the shareholder proposal process, existing regulatory requirements, including current ownership and resubmission requirements, costs and benefits involved for the company and shareholders, and proposals for action, if any; and

(3) the level of retail shareholder participation, its causes, and whether the relatively low level of retail participation compared to institutional investors is cause for concern.

I note that, although not an exact overlap, your three topics correspond fairly closely with the three panels at the recent Roundtable on the Proxy Process (the 2018 Proxy Process Roundtable) which the SEC staff held at its Washington headquarters on November 15.[1] I was heartened to see that the SEC, under the strong leadership of Chairman Jay Clayton, is once again actively considering these issues.

---

1 Press Release, SEC Announces Agenda, Panelists for Staff Roundtable on the Proxy Process (Nov. 8, 2018), *available at* https://www.sec.gov/news/press-release/2018-260.

I. The Role of Proxy Advisory Firms

During my time on the Commission, I spoke and wrote frequently about the need to reform the outdated regulatory regime governing the shareholder voting process and to address the outsized role of proxy advisory firms in this process.[2] Developments in investment behavior over the past 20 years have worked fundamental changes to the corporate governance landscape, and our existing regulatory regime has not caught up with these changes. The current environment creates an undue reliance on proxy advisory firms that policymakers did not anticipate as they worked to address the evolving shareholder voting landscape. Institutional ownership of shares was once negligible; now, it predominates.[3] This shift is important because individual investors are generally rationally apathetic when it comes to shareholder voting: value potentially gained through voting is outweighed by the time spent determining how to vote on numerous individual matters and actually casting those votes. In contrast, institutional investors possess economies of scale, so they regularly vote billions of shares each year on thousands of ballot items for the thousands of companies in which they invest.[4]

For example, an investor purchasing a share of an S&P 500 index mutual fund likely would have no interest in how each proxy is voted for each of the securities in each of the companies held by that fund. Indeed, reviewing individual voting items would defeat the purpose of selecting such a low-maintenance, low-cost investment alternative. Ultimately, the investor leaves the voting decision to the investment adviser to the index fund. The investor's reliance on the investment adviser inevitably results in a classic agency problem: how do we make sure that the investment adviser is voting those shares in the investor's best interest, rather than the adviser's best interest?

A. The Rise of Proxy Advisory Firms

The Commission tackled this very issue in a rulemaking in 2003, putting in place disclosure requirements to inform investors how their funds' advisers are voting, as well as outlining clear steps that advisers must undertake to ensure that they vote shares in the best

---

2 *See, e.g.,* SEC Commissioner Daniel M. Gallagher, Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School: Federal Preemption of State Corporate Governance (Mar. 27, 2014) (Gallagher Tulane Remarks), *available at* https://www.sec.gov/news/speech/2014-spch032714dmg.html; SEC Commissioner Daniel M. Gallagher, Remarks at Georgetown University's Center for Financial Markets and Policy Event (Oct. 30, 2013), *available at* https://www.sec.gov/news/speech/2013-spch103013dmg. Portions of this testimony are excerpted from my article *Outsized Power and Influence: The Role of Proxy Advisors,* Washington Legal Foundation (Aug. 2014), and the Gallagher Tulane Remarks.

3 Between 1950 and 2000, institutional ownership of total U.S. equity outstanding increased from approximately 6% to approximately 50%, where it has since remained. *See* Matteo Tonello & Stephan Rabimov, *The 2010 Institutional Investment Report: Trends in Asset Allocation and Portfolio Composition* (The Conference Board, 2010) at 22. Within the top 1,000 U.S. corporations, institutional investors are even more entrenched, holding nearly 75% of the equity. *Id.* at 27. *See also* Broadridge & PwC, *Proxy Pulse: 2018 Proxy Season Review* (2018) at 2 (Proxy Pulse) (noting that in 2018, institutional ownership of public company shares was 70%).

4 *See* Proxy Pulse at 2 (noting that institutional shareholders voted 91% of their shares through June of 2018, while individual investors voted only 28% of their shares).

interest of their clients.[5] But, as always, regulatory intervention carries with it the risk of unintended consequences.[6] The 2003 release has since proved that to be true – to the point where the costs of the unintended consequences now arguably dwarf the benefits the Commission sought to achieve. In fact, the ultimate result of regulatory intervention has been a direct increase in the extent to which for-profit third party proxy advisers, which have no economic risk in the underlying investments, drive decision making at investment advisers and corporations.

In its 2003 release, the SEC addressed one specific and narrow manifestation of the general agency problem: that an adviser could have a conflict of interest when voting a client's securities on matters that affect the adviser's own interests (*e.g.*, if the adviser is voting shares in a company whose pension the adviser also manages). To remedy this issue, the release stated that an investment adviser's fiduciary duty to its clients requires the adviser to adopt policies and procedures reasonably designed to ensure that it votes its clients' proxies in the best interest of those clients.[7] The Commission also noted that "an adviser could demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, *based upon the recommendations of an independent third party*."[8] From these statements, two specific unintended consequences arose.

First, some investment advisers interpreted this rule as requiring them to vote every share, every time, which led to an outsourcing of voting decisions. This interpretation seemed, perhaps, to be the natural outgrowth of the Department of Labor's (DOL) 1988 "Avon Letter," which stated that "the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock."[9] As a result, investment advisers with investment authority over ERISA plan assets – and thus regulated by the DOL as well as the SEC – were already required to cast a vote on every matter. Reading the SEC's 2003 rule, some advisers understandably may have assumed that the Commission intended to codify that result for all investment advisers.

A requirement to vote every share on every vote, however, gives rise to a significant economic burden for investment advisers who may own only relatively small holdings in a large number of companies. For example, one study found that "[m]ost institutional investor holdings are relatively small portions of each firm's total securities."[10] In this study's sample, "the mean

5 SEC Rel. No. IA-2106, *Proxy Voting by Investment Advisers* (Jan. 31, 2003), *available at* https://www.sec.gov/rules/final/ia-2106.htm. While this release requires advisers to disclose how clients can obtain information about how their securities were voted, actual disclosure requirements were set out in a companion release issued the same day. *See* SEC Rel. No. IC-25922, Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (Jan. 31, 2003), *available at* https://www.sec.gov/rules/final/33-8188.htm.

6 This is particularly true where the intervention takes the form of a mandate, as opposed to a market-based solution (*e.g.*, disclosure and explanation of proxy votes to investors, who could then choose to remain in the fund or take their money elsewhere).

7 *See* SEC Rel. No. IA-2106, *Proxy Voting by Investment Advisers* (Jan. 31, 2003).

8 *Id.* (emphasis added).

9 *See* Letter from Allan Lebowitz, Deputy Assistant Sec'y of the Pension Welfare Benefits Admin. at the U.S. Dep't of Labor, to Helmuth Fandl, Chairman of the Ret. Bd., Avon Products, Inc. (Feb. 23, 1988), *available at* http://online.wsj.com/public/resources/documents/ProxyAdvisoryWhitePaper02072011.pdf.

10 David F. Larcker, Allan L. McCall, and Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy*

(median) holding [of an individual stock by institutional investors] is 0.3% (0.03%)."[11] Given that institutional investors hold stock in hundreds or thousands of companies (for example, TIAA-CREF holds stock in 7,000 companies),[12] institutional investors – particularly the smaller ones – may not be able to invest in the costly research needed to ensure that they cast each vote in the best interest of their clients. The logical response is to outsource the research function to a third party, who could do the needed research and sell voting recommendations back to investment advisers for a fee: a proxy advisory firm. Although these firms already existed, the 2003 rule gave advisers new incentives to use them.

Second, investment advisers understandably came to view reliance on proxy advisory firms as a litigation and government enforcement insurance policy: for the price of purchasing the proxy advisory firm's recommendations, an investment adviser could ward off potential liability for its conflicts of interest.[13] Proxy advisory firms noticed the suggestion in the 2003 rule that soliciting the views of an independent third party could overcome an adviser's conflict of interest. In 2004, a proxy advisory firm requested – and received – "no-action" relief from the SEC staff that significantly expanded investment advisers' incentive to use these firms. Specifically, the staff advised advisory firm Egan-Jones that "an investment adviser that votes client proxies in accordance with a pre-determined policy based on the recommendations of an independent third party will not necessarily breach its fiduciary duty of loyalty to its clients even though the recommendations may be consistent with the adviser's own interests. In essence, the recommendations of a third party who is in fact independent of an investment adviser may cleanse the vote of the adviser's conflict."[14]

Subsequent SEC action further exacerbated these unintended consequences. In a second 2004 no-action letter to ISS,[15] the SEC staff endorsed the notion that "an investment adviser may determine that a proxy voting firm is capable of making impartial proxy voting recommendations in the best interests of the adviser's clients based on the procedures that the proxy voting firm has adopted and implemented to insulate the firm's voting recommendations from incentives to vote the proxies to further the firm's relationships with issuers" and confirmed its position from the Egan-Jones letter that a key aspect of some proxy advisory firms' business models – selling corporate governance consulting services to companies – "generally would not affect the firm's

---

Advisory Firms (May 10, 2013) at 10 (Outsourcing Shareholder Voting), *available at* http://www.shareholderforum.com/access/Library/20130510_Larcker-McCall-Ormazabal.pdf.

11 *Id.*

12 *See* James K. Glassman and J. W. Verret, *How to Fix Our Broken Proxy Advisory System*, Mercatus Research (Apr. 16, 2013), *available at* http://mercatus.org/sites/default/files/Glassman_ProxyAdvisorySystem_04152013.pdf.

13 *See* Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (And Europe) Face*, 30 DEL. J. OF CORP. LAW 688 (2005) (noting that following the recommendation of a proxy advisory firm "constitutes a form of insurance against regulatory criticism").

14 *See* Letter from Douglas Schiedt, Associate Director and Chief Counsel, Division of Investment Management U.S. Securities and Exchange Commission, to Kent S. Hughes, Managing Director, Egan-Jones Proxy Services (May 27, 2004) (Egan-Jones Letter), *available at* https://perma.cc/KSJ2-JP5N.

15 *See* Letter from Douglas Schiedt, Associate Director and Chief Counsel, Division of Investment Management U.S. Securities and Exchange Commission, to Mari Anne Pisarri on behalf of Institutional Shareholder Services, Inc. (Sep. 15, 2004), *available at* https://perma.cc/Q8YH-SAXR

independence from an investment adviser."[16] This determination is somewhat incredible, as it places the proxy advisory firm in the position of telling investment advisers how to vote proxies on companies' corporate governance matters that are the subject of the proxy advisory firm's consulting services provided to those same companies—a seemingly obvious, and insurmountable, conflict of interest for the proxy adviser.[17]

Thus, in addition to selling vote recommendations to institutional investors (along with voting platforms, data aggregation, and other auxiliary services), proxy advisory firms sell consulting services to companies that want to ensure that they have structured their governance and other proxy votes so as to avoid "no" recommendations from the proxy advisory firms. The sale of voting recommendations to institutional investors makes real the risk that proxy advisory firms, in formulating their core voting recommendations, will be influenced by the proxy advisory firms' business interests. Moreover, the sale of consulting services to companies creates a risk that proxy advisory firms would be lenient in formulating voting recommendations for companies that are their clients and harsh in crafting the recommendations for those companies that have refused to retain their services. As a whole, the existing system creates incentives for proxy advisory firms to evaluate governance structures in a way that maximizes continued reliance on the services such firms provide.

The 2003 release and the 2004 no-action letters set the stage for proxy advisory firms to wield the power of the proxy through investment adviser firms that had economic, regulatory, and liability incentives to rely rotely on the proxy advisory firms' recommendations, and through the SEC staff's assurances that this arrangement was appropriate, despite the obvious conflicts of interest involved.

I am extremely pleased to note that the SEC staff withdrew the ISS and Egan-Jones letters just a few months ago,[18] and Chairman Clayton wisely reminded investors, market professionals and the securities bar that "staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties."[19] As a result, I am hopeful that some of the unfettered power that was ascribed to proxy advisory firms over the past 15 years has been reined in. I also understand that the issues underlying the ISS and Egan-Jones letters are being reviewed and evaluated again by the SEC staff, including against the backdrop of feedback the Commission received from the 2018 Proxy Process Roundtable, so we may hear more from the Commission or its staff on these points in the near future.

As investment advisers consider the potential risks of reliance on proxy advisory firm analysis and corporations continue to highlight quality and conflict of interest concerns related to such analysis, all market participants should welcome this review. Because additional regulatory

---

16 *See* Egan-Jones Letter.

17 The auditor independence rules, by contrast, flatly forbid an auditor from telling an audit client how to account for a matter, and then providing an audit opinion to investors with respect to that exact same matter. *See* SEC Rule 2-01(b) & (c)(4) of Regulation S-X. The temptation for one side of the house to rubber-stamp the advice provided by the other side of the house is simply too great.

18 Public Statement, Statement Regarding Staff Proxy Advisory Letters (Sep. 13, 2018), *available at* https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters.

19 SEC Chairman Jay Clayton, *Statement Regarding SEC Staff Views* (Sep. 13, 2018), *available at* https://www.sec.gov/news/public-statement/statement-clayton-091318.

developments since the 2003 release and the 2004 no-action letters have strengthened further proxy advisory firms' hands, the withdrawal of the 2004 letters alone is not sufficient.

B. *Subsequent Developments Augmenting the Power of Proxy Advisory Firms*

Since 2003, other elements of the SEC regulatory regime have acted to deepen further investment advisers' reliance on, and perhaps even need for, proxy advisory firms. First, the quantity of company disclosures has increased significantly over the past decade. For example, the SEC in 2006 adopted revisions to the proxy and periodic reporting rules to require extensive new disclosures about "executive and director compensation, related person transactions, director independence and other corporate governance matters and security ownership of officers and directors."[20] The revisions generated reams of new disclosures that were long, complex, and focused on regulatory compliance rather than telling the company's compensation story. The sheer volume of information that an investment adviser would have to review in order to make a fully-informed voting decision is difficult even to organize, much less to read and digest.

Additionally, the average number of items on which investors are asked to vote also has increased.[21] This trend is attributable at least in part to the Dodd-Frank Act and its twin advisory votes on executive compensation: a vote for how often shareholders should be asked to approve executive pay ("say-on-frequency"), and a vote to in fact approve (or disapprove) that pay on an advisory basis ("say-on-pay").[22] I will address shareholder proposals in more detail later, but we also have seen a continued increase in shareholder proposals that SEC rules generally compel companies to include as voting matters in the proxy. These additional matters continue to increase the burden placed on investors and investment advisers in deciding whether and how to vote the shares they represent.

As a result, the logistical and economic imperatives to use proxy advisory firms that the vote-every-share-every-time interpretation of the 2003 rulemaking created have only strengthened over time. According to one 2012 study, for example, over 70% of companies reported that their compensation programs were influenced by the guidance of proxy advisers.[23] And, according to a survey conducted in 2015, 63% of institutional investors reported that they rely on third-party proxy advisers to make voting decisions.[24] More recently, research from the American Council for Capital Formation (ACCF) identifies that many asset managers are

---

[20] SEC Rel. No. 33-8732A, *Executive Compensation and Related Person Disclosure* (Aug. 29, 2006), *available at* https://www.sec.gov/rules/final/2006/33-8732a.pdf.

[21] *See, e.g.,* Larcker et al., Outsourcing Shareholder Voting at 1.

[22] *See also* SEC Commissioner Michael S. Piwowar, Opening Statement at the Proxy Advisory Services Roundtable (Dec. 5, 2013) (Piwowar Proxy Adviser Remarks), https://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542558180 ("Dodd-Frank provisions, such as mandatory say-on-pay votes, make proxy advisory firms potentially even more influential.").

[23] *See* David F. Larcker, Allan L. McCall, and Brian Tayan, *The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions* (Mar. 2012) at 4, *available at* https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survey-2012-proxy-voting_0.pdf.

[24] *See* Stanford University Graduate School of Business, *2015 Investor Survey Deconstructing Proxy Statements – What Matters to Investors* (2015) at 2, *available at* https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf.

automatically voting in alignment with proxy advisory firm recommendations, in a practice known as "robo-voting."[25] Specifically, the ACCF study found that 175 entities, representing more than $5 trillion in assets under management, follow ISS's recommendations over 95% of the time. These recommendations are provided contractually to investment advisers; as mentioned, proxy advisory firms have no fiduciary duty to shareholders, nor do they have any interest or stake in the companies that are the subject of the recommendations.

Proxy advisory firms themselves face the same difficulties institutional investors faced before the institutions determined to outsource their voting: how to formulate timely, high-quality recommendations for thousands of votes at thousands of companies based on millions of pages of data – all while competing on price with other firms. Not surprisingly, their recommendations often are just not good enough, and proxy advisory firms publish some recommendations that are based on clear, material mistakes of fact.[26] Moreover, they base some recommendations on a cookie-cutter approach to governance – *i.e.*, in favor of all proposals of a certain type, like de-staggering boards or removing poison pills, even if there is a sound basis for challenging the assumption that an otherwise beneficial governance reform might not be appropriate for a given company. As one academic article has argued:

> If the institutional investors are only using the proxy advisor voting recommendations to meet their compliance requirement with the lowest cost, these payments will not compensate proxy advisors for conducting research that is necessary to determine appropriate corporate governance structures for individual firms. Under this scenario, the resulting recommendations will tend to be based on simple, low cost approaches that ignore the complex contextual aspects that are almost certainly instrumental in selecting the corporate governance structure for individual firms.[27]

---

[25] *See* "The Realities of Robo-Voting," posted by Timothy M. Doyle, American Council for Capital Formation (ACCF), to the Harvard Law School Forum on Corporate Governance and Financial Regulation, November 29, 2018, *available at* https://corpgov.law.harvard.edu/2018/11/29/the-realities-of-robo-voting/.

[26] *See, e.g.,* Center On Executive Compensation, *A Call for Change in the Proxy Advisory Industry Status Quo* (Jan. 2011) at 58-9 (describing two member surveys conducted by the Center On Executive Compensation and HR Policy Association in 2010 which found significant rates of error in proxy advisory firm research and reports on executive compensation matters), *available at* http://online.wsj.com/public/resources/documents/ProxyAdvisoryWhitePaper02072011.pdf. *See also* Letter from Business Roundtable on Proxy Advisory Firms, to Mary Jo White, SEC Chairman (Sept. 12, 2013), *available at* http://businessroundtable.org/resources/letter-to-chairman-white-on-proxy-advisory-firms (in its inquiry, almost all of the twenty companies that responded indicated that they historically have found one or more factual errors in the reports prepared by proxy advisory services). A 2016 decision from the Delaware Chancery Court sheds additional light on the complex plumbing currently underlying the proxy voting process, as well as the potential pitfalls surrounding reliance on proxy advisory firms. In that case, the Court concluded that certain investors had given up their appraisal rights in connection with a merger transaction based upon an error – albeit apparently inadvertent – on the part of ISS in transmitting voting instructions to Broadridge, the entity ultimately responsible for executing the proxies at issue. The Court held that by relying on ISS to transmit its voting instructions, the investment adviser "accepted the risk" that ISS might ultimately pass along voting instructions that were inconsistent with the adviser's wishes. *See In re Appraisal of Dell, Inc.*, C.A. No. 9322-VCL (Del. Ch. Ct. May 11, 2016), *available at* https://courts.delaware.gov/Opinions/Download.aspx?id=240830.

[27] See Larcker et al., Outsourcing Shareholder Voting at 3; *see also* James K. Glassman & Hester Peirce, *How*

Unfortunately, companies have little access to proxy advisory firms in order either to correct a mistake of fact, or to explain why a generic corporate governance recommendation is the wrong result in the specific instance: letting companies appeal to the advisory firm is time-consuming and expensive, neither of which is consistent with the proxy advisory firm's business model. As a result, while the companies that also hire a proxy advisory firm for the latter's corporate consulting services may have some minimal degree of access (*e.g.*, by being provided an opportunity to make limited comments on draft reports), smaller companies that are not clients generally are not afforded any such rights.

Advisers that rely wholesale on the proxy advisory firm's recommendations also tend not to afford companies an opportunity to tell their story. This is unsurprising: if the advisers felt it necessary to spend significant time and make contextualized decisions about casting each vote, they would not have outsourced their vote. But it is also supremely ironic: under the current regulatory regime, a company that may want to engage in good faith with its shareholders may find that it has no meaningful opportunity to do so.

The cookie-cutter approach to governance combined with the limited opportunities for companies to tell their story is deeply troubling to me. Without consideration of both sides of a voting item on a case-by-case basis, there is no way of knowing if a particular outcome is in the best interests of shareholders. Indeed, this discussion is about much more than arguments over whether a statement in a proxy advisory firm's analysis is an error or a difference of opinion. Regardless of whether a dispute is over the facts, the analysis or the methodology, investors deserve to hear both sides of the story. Reform should make sure that all sides are able to express their concerns to investment advisers before votes are cast.

The rise of proxy advisers and the outsized influence they wield on the shareholder voting process have real consequences for investors, the vast majority of whom are interested in maximizing the value of their shares. In conducting their analysis, proxy advisory firms routinely fail to demonstrate how (or whether) their recommendations increase shareholder value. If investment advisers are relying on proxy adviser analysis, an explanation of how a particular recommendation relates to shareholder value is essential. Recent research shows that "when public companies implement certain 'best practices' promulgated by proxy advisers — in this case with regard to stock option exchange programs — their gains in shareholder value are on average 50% to 100% less than other firms."[28] Another study analyzed the impact of say-on-pay voting requirements under the Dodd-Frank Act and found that "compensation changes desired by

Proxy Advisory Services Became So Powerful, Mercatus on Policy (June 2014), *available at* http://mercatus.org/sites/default/files/Peirce-Proxy-Advisory-Services-MOP.pdf (noting that "one-size-fits-all recommendations miss the nuances of particular corporations").

28 David F. Larcker and Allan L. McCall , "Proxy Advisers Don't Help Shareholders," WALL ST. J. (Dec. 8, 2013), *available at* http://www.wsj.com/articles/SB10001424052702303497804579241842269425358. *See also* Robert Daines, Ian Gow, and David Larker, *Rating the Ratings: How Good Are Commercial Governance Ratings*, Rock Center for Corporate Governance at Stanford University Working Paper Series No. 1 (Sept. 4, 2009) (finding that corporate governance ratings produced by certain proxy advisory firms and other corporate governance rating organizations "have either limited or no success in predicting firm performance or other outcomes of interest to shareholders").

proxy advisory firms produce a net cost to shareholders, while compensation changes not related to proxy advisors' criteria are value-neutral."[29] The study concluded that outsourcing voting decisions to proxy advisers appears to have the unintended consequence that boards of directors are induced "to make compensation decisions that *decrease* shareholder value."[30]

C. *The Initial Regulatory Response*

Concerns surrounding proxy advisory firms have been on the SEC's radar for some time now, most notably when they were raised in the 2010 Concept Release on the U.S. Proxy System (Proxy Plumbing release). This release outlined the conflict-of-interest and low-quality voting recommendation issues addressed above, and it requested comment on a long list of potential regulatory solutions. In December 2013, the SEC also held a roundtable (the 2013 Roundtable) to examine key questions about the influence of proxy advisory firms on institutional investors, the lack of competition in this market, the lack of transparency in the proxy advisory firms' vote recommendation process and, significantly, the obvious conflicts of interest when proxy advisory firms provide advisory services to issuers while making voting recommendations to investors. Then Commissioner Michael Piwowar correctly pointed out in his opening remarks at the 2013 Roundtable:

> By requiring advisers to vote on every single matter – irrespective of whether such vote would impact the performance of investment portfolios – our previous actions may have unintentionally turned shareholding voting into a regulatory compliance issue, rather than one focused on the benefits for investors. This is an unfortunate result, not merely because it may have served to entrench an anti-competitive duopoly, but more importantly because it is inconsistent with our investor protection mandate. For these reasons, we should rectify this situation immediately.[31]

A wide range of other parties, including members of Congress, academics, public interest groups, the media, and a national securities exchange, also have been calling for reforms.[32] There also has been substantial interest and work regarding the role of proxy advisers on the international front, including legislation introduced by the European Commission to address the accuracy and reliability of proxy advisers' analysis as well as their conflicts of interest.[33]

---

29 David F. Larcker et al., Outsourcing Shareholder Voting at 36.

30 *Id.* at 45.

31 Piwowar Proxy Adviser Remarks.

32 *See* SEC Commissioner Daniel M. Gallagher, Remarks at Georgetown University's Center for Financial Markets and Policy Event (Oct. 30, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370540197480. *See also, e.g.,* Yin Wilczek, *If SEC Fails to Move on Proxy Advisors, Lawmaker Promises Congressional Action*, Bloomberg BNA (June 20, 2014), *available at* https://www.bna.com/sec-fails-move-n17179891458/ (discussing Congressman McHenry's promise of congressional action in the absence of three key reforms: repealing the no-action letters; identifying transparency, efficiency, and accountability measures for proxy advisory firms; and permitting portfolio managers to use cost-benefit analysis to determine whether to cast a vote); Comments of the Washington Legal Foundation on Issues Raised at the Proxy Advisory Firm Roundtable (Jan. 10, 2014), *available at* http://www.wlf.org/upload/litigation/misc/SECProxyAdvisorComments_Jan2014.pdf.

33 *See* Proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC

After the SEC's concept release and the 2013 Roundtable, which provided a wealth of information and perspectives, the SEC staff on June 30, 2014 moved toward addressing some of the serious issues involving proxy advisers. The Division of Investment Management and the Division of Corporation Finance released Staff Legal Bulletin No. 20 (SLB 20), providing much-needed guidance and clarification as to the duties and obligations of proxy advisers, and to the duties and obligations of investment advisers that make use of proxy advisers' services.[34] This guidance was a good, initial step in addressing the serious deficiencies currently plaguing the proxy advisory process.

In particular, SLB 20 did three important things worth highlighting. First, it clarified the widespread misconception discussed above that the Commission's 2003 release mandates that investment advisers cast a ballot for each and every vote. The guidance made clear that an investment adviser and its client have significant flexibility in determining how the investment adviser should vote on the client's behalf, including by agreeing that votes will be cast always, sometimes (*e.g.*, only on certain key issues), or never. SLB 20 also noted that the investment adviser and client can agree to vote consistent with management's recommendations.

Second, SLB 20 cautioned against misguided reliance on the two 2004 staff no-action letters. The guidance made clear that investment advisers have a continuing duty to monitor the activities of their proxy advisers, including whether, among other things, the proxy advisory firm has the capacity to "ensure that its proxy voting recommendations are based on current and *accurate* information."[35] This is an important issue, as I have heard from many companies that proxy advisory firms sometimes produce recommendations based on materially false or inaccurate information, but they are unable to have the proxy advisory firm even acknowledge these claims, much less review them and determine whether to revise its recommendation in light of the corrected information. The recent withdrawal of the 2004 staff no-action letters should ameliorate any misplaced reliance on old habits, but I worry that it's not enough.

Third, SLB 20 made clear that a proxy advisory firm must disclose to recipients of voting recommendations any significant relationship the proxy advisory firm has with a company or security holder proponent. This critical disclosure must clearly and adequately describe the nature and scope of the relationship, and boilerplate will not suffice.

D. The Limits of SLB 20 and The Need for Additional Reforms

While the increased attention and initial reforms described above were a step in the right direction, more work needs to be done to address the outsized role proxy advisers continue to

as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (Apr. 9, 2014), *available at* https://eur-lex.europa.eu/resource.html?uri=cellar:59fccf6c-c094-11e3-86f9-01aa75ed71a1.0003.01/DOC_1&format=PDF.

34 Division of Investment Management and Division of Corporation Finance, U.S. Securities and Exchange Commission, 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) (SLB 20), *available at* https://www.sec.gov/interps/legal/cfslb20.htm.

35 SLB 20 (emphasis added).

play in the shareholder voting process. I am hopeful that the 2018 Proxy Process Roundtable will lead to additional guidance or regulatory reforms from the SEC. It is long past time to have a balanced system that efficiently and effectively furthers the interests and needs of shareholders, their investment advisers, and the public companies in which they invest.

And while SLB 20 was a good first step, I remain concerned that the guidance does not fully address the fact that SEC rules have accorded to proxy advisers a special and privileged role in our securities laws – a role similar to that of nationally recognized statistical ratings organizations (NRSROs) before the financial crisis. It has become clear to me that, over the past decade, certain segments of the investment adviser industry have become too dependent on proxy advisory firms, and there is therefore a risk that these firms will not take full advantage of the SEC's guidance to reduce that reliance. Over four years after SLB 20 was released, many market participants seem to have simply taken a "business as usual" approach. This approach is manifest in the continued market dominance of the two largest proxy advisory firms, ISS and Glass, Lewis & Co. ISS alone advises more than 60% of U.S. institutional investors on how to vote on corporate ballot items.[36]

Different pieces of proposed legislation over the past five years have put forth the idea that proxy advisory firms should be registered with the SEC, just as our system requires registration of broker-dealers and investment advisers. In 2016, Congressman Sean Duffy and now former Congressman (and current Delaware Governor) John Carney introduced the Corporate Governance Reform and Transparency Act to create a new SEC registration and oversight regime for proxy advisory firms similar to that which Congress put in place for credit rating agencies in 2006. That bill was ultimately passed in the House with bipartisan support.

Most recently, the bipartisan Corporate Governance Fairness Act was introduced by Senators Reed, Perdue, Jones, Tillis, Heitkamp and Kennedy of this Committee.[37] The bill would require the SEC to regulate and inspect all major proxy advisory firms under the Investment Advisers Act. As the press release announcing the bill stated, "[The advice of proxy advisory firms] is critical for investors as they decide how to vote their shares on important corporate governance matters, such as director elections or whether to sell the company."[38]

Congressional attention to the issue of proxy advisory firm oversight is important and needed, and it is truly refreshing to see bipartisan efforts to provide an appropriate regulatory framework for these firms given the impact they have on corporate governance in the U.S. Absent such efforts, the outsized role of proxy advisory firms will only continue to grow.

---

36 *See* James K. Glassman, "Regulators Are a Proxy Advisers Best Friend," WALL ST. J. (Dec. 17, 2014), *available at* https://www.wsj.com/articles/james-k-glassman-regulators-are-a-proxy-advisers-best-friend-1418863046. *See also* James Copland, David Larcker, and Brian Tayan, *Proxy Advisory Firms, Empirical Evidence And The Case For Reform* (May 2018) at 13 (finding that an against recommendation from proxy advisors "is associated with a reduction in the favorable vote count by 15%-30%"), *available at* https://www.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf.

37 S. 3614, 115th Cong. (2018), *available at* https://www.congress.gov/115/bills/s3614/BILLS-115s3614is.pdf.

38 Press Release, Tillis Introduces Bipartisan Legislation to Protect Investors and Ensure Proper Oversight of Proxy Advisory Firms (Nov. 14, 2018), *available at* https://www.tillis.senate.gov/public/index.cfm/2018/11/tillis-introduces-bipartisan-legislation-to-protect-investors-and-ensure-proper-oversight-of-proxy-advisory-firms.

II. The Shareholder Proposal Process

It is important to discuss the role of proxy advisory firms in influencing the votes that investors and investment advisers cast, but we also must consider the matters upon which investors or their advisers are asked to cast votes, and why. While the conduct of a company's annual shareholder meeting is generally governed by state law, the process of communicating with shareholders to solicit proxies for voting at that meeting is regulated by the Commission under federal law. The Commission's rules have for decades permitted qualifying shareholders to require the company to publish certain proposals in the company's proxy statement, which are then voted upon at the annual meeting. Whether the Commission's rule on shareholder proposals (Rule 14a-8) was right or wrong when initially adopted in December 1942, the shareholder proposal process is now replete with defects and inefficiencies. I spoke about the need for reform in this area in remarks I gave at the 26th Annual Corporate Law Institute at Tulane University Law School back in 2014.[39] Unfortunately, little has changed since then.

The Commission has never adequately assessed the costs and benefits of its shareholder proposal process. Currently, a proponent can bring a shareholder proposal pursuant to Rule 14a-8 if he or she has owned $2,000, a threshold established 20 years ago, or 1% (whichever is less) of the company's stock for one year, so long as the proposal complies with a handful of substantive—but in some cases discretionary—requirements. Activist investors and corporate gadflies have used these loose rules to hijack the shareholder proposal system to advance their own environmental, social and political agendas.

The data and statistics are striking. During the 2018 proxy season, there were 788 shareholder proposals appearing in corporate proxy statements and 43% of those proposals addressed social and environmental issues, with 11% taking up lobbying activities and political contributions.[40] Of all shareholder proposals that appeared in proxy statements, only 10% received a majority vote in favor from shareholders.[41] The ESG proposals that accounted for 43% of the total number of proposals—only about 5% of those received majority shareholder support.[42]

Also, these proposals are not coming from ordinary shareholders concerned with promoting shareholder value for all investors. Last year, about 19% came from pension funds and organized labor, about 46% came from religious and social policy investors and fully 25% came from one particular individual and his associates who have made a trade in submitting 14a-

---

39 Gallagher Tulane Remarks.

40 *See* Gibson Dunn, *Client Alert: Shareholder Proposal Developments During the 2018 Proxy Season* (July 12, 2018) at 3–4, *available at* https://www.gibsondunn.com/wp-content/uploads/2018/07/shareholder-proposal-developments-during-the-2018-proxy-season.pdf.

41 *See id.* at 5.

42 *See* Institutional Shareholder Services, *U.S. Environmental and Social Issues, 2018 Proxy Season Review* (Aug. 30, 2018) at 7, *available at* https://www.isscorporatesolutions.com/library/2018-es-us-proxy-season-review/.

8 proposals to multiple companies.[43]

In other words, the vast majority of proposals are brought by individuals or institutions with idiosyncratic and sometimes political agendas that are often unrelated to, or even in conflict with, the interests of other shareholders. As Commissioner Elad Roisman said in his opening remarks at the 2018 Proxy Process Roundtable last month, "We have to strike a balance [...] between proponents who seek to increase shareholder value with their proposals and those who exploit the process to further their personal agenda. Proposals brought by the latter can be a waste of shareholders' time and money, as it is the shareholders who ultimately bear the costs companies spend defending these proposals."[44] In an era when more and more Americans are relying on their individual investments to secure their retirements and send their kids to college, it seems to me they are entitled to their regulators' vigilance in staving off needless waste in those investment systems.

Given all of this, it's time we asked whether the shareholder proposal system as currently designed is a net negative for the average investor.[45] Existing shareholders who are unhappy with management have a range of well-accepted responses other than proposals. Given the depth and liquidity of today's markets, passive investors can simply sell their position—taking the so-called "Wall Street Walk." Investors can threaten to take this Walk as a means of influencing management. Investors can also vote against directors who are not sufficiently overseeing management. And, of course, where management is breaching its fiduciary duties, investors can have recourse to the courts.

In a series of speeches during my time on the Commission, I proposed a number of modest reforms to Rule 14a-8, including, among others, revising the absurdly low holding requirements needed to submit a shareholder proposal and moving to a percentage test; clarifying and bolstering requirements regarding the substance of shareholder proposals; and increasing the thresholds required to re-submit a failed shareholder proposal from one year to the next.[46] From comments made by the Commissioners, SEC staff and panel participants at the 2018 Proxy Process Roundtable, I believe some of this low-hanging fruit is easily within reach, and I am cautiously optimistic that we may see progress on this front in the near term (or at least in our lifetimes).

III. Retail Shareholder Participation

As I noted at the beginning of my remarks, individual investors are generally rationally apathetic when it comes to shareholder voting: value potentially gained through voting is outweighed by the burden of determining how to vote and actually casting that vote. This can be an optimal state and should not be conflated with a notion that retail investors have been

---

43 *See* James Copland and Margaret O'Keefe, *Proxy Monitor 2017: Season Review*, *available at* http://www.proxymonitor.org/Forms/pmr_15.aspx.

44 SEC Commissioner Elad L. Roisman, *Statement at Proxy Process Roundtable* (Nov. 15, 2018), *available at* https://www.sec.gov/news/public-statement/statement-roisman-111518.

45 Allan T. Ingraham & Anna Koyfman, *Analysis of the Wealth Effects of Shareholders Proposals-Vol. III* (U.S. Chamber of Commerce, May 2, 2013).

46 *See, e.g.*, Gallagher Tulane Remarks.

disenfranchised. At the same time, I am aware of several efforts to increase retail investors' participation in the proxy process by making it easier for individuals to make and communicate their own voting decisions in a cost-effective manner. I think this is an important area that this Committee has rightly taken up today as part of its evaluation of the proxy system in the U.S.

A little historical context may be helpful in understanding the changing role played by individual investors in our markets today. Although over half (about 55%) of Americans are invested in the stock market in one way or another today[47], many of those investments are made through mutual funds and portfolio accounts rather than through direct investment in the stocks of any particular companies.[48] This reflects a consistent trend line over the past half century of declining direct stock ownership by retail (individual) investors – in 1950, individual investors held almost 94% of corporate stock; in 1980, the percentage held by individuals had slipped but still represented a sizeable majority with more than 70% of the market.[49] By 2000, institutional investors held almost half of all stock in the American market and just recently, in 2018, the percentage held by individual investors had fallen to only 30%.[50]

Thirty percent is still a pretty good chunk, though. Certainly a block of 30% could make a difference in many elections, and yet less than 30% (about 28%) of the shares held by retail investors were voted at American companies' annual meetings last year.[51] I noted earlier why that may be predictable and optimal, but there are also systemic roadblocks to retail participation that warrant a closer look. Even when they hold stock in individual companies, retail investors still must rely on a market intermediary—a brokerage firm—to facilitate the voting process. The individual who invested his or her money typically does not even show up in the corporate records as a shareholder: the brokerage firm holds those shares in "street name." The broker then needs to pass along proxy statements and solicit votes from the actual, so-called "beneficial" owners. That's a tedious system with needless costs and inefficiencies.

As a side point, I'd also note that a change to the New York Stock Exchange's rules on the heels of the Dodd-Frank Act also cast a pall over retail voting. (Regardless of which exchange a company's stock is traded on, brokers as members of the NYSE must follow its rules.) Back in 2009, the NYSE, with a newly reconstituted Commission's encouragement, amended its rule concerning the matters on which brokers can cast discretionary votes– in other words, if a broker has not received express voting instructions from its customer, can it still cast a vote for its retail customers' shares?[52] Brokers can only do that for so-called "routine" matters.

---

47 *See* Gallup News Service, *Gallup Poll Social Series: Economy and Personal Finance* (Apr. 2–11, 2018), *available at* https://news.gallup.com/file/poll/233747/180504StockOwnership.pdf.

48 *See* Sarah Holden, Daniel Schrass, and Michael Bogden, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2017* (Oct. 2017), *available at* https://www.ici.org/pdf/per23-07.pdf.

49 *See* Matteo Tonello & Stephan Rabimov, *supra* note 3 at 22.

50 *See id.;* Proxy Pulse at 4.

51 *See* Proxy Pulse at 4.

52 SEC Release No. 34-60215, *Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company* (Jul. 1, 2009), *available at* https://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf.

It used to be that routine matters included uncontested director elections, but not so after the 2009 rule change (proxy contests have never been routine).[53] The say-on-pay votes to which Dodd-Frank subjected public companies are not "routine" matters either.[54] There's not much left – often only the ratification of the independent auditor. In a very real sense, it's more complicated and burdensome for a retail investor to vote on matters on a company's proxy card than it is for big, highly resourced institutional investors.

Chairman Clayton has been clear from day one of his tenure at the SEC that the interests of retail investors would be of paramount concern to the Commission.[55] This is a needed and refreshing focus for the Commission. As part of this emphasis on retail investor issues, the SEC's Investor Advisory Committee recently held a meeting focused on proxy voting issues[56] and, of course, the SEC staff recently held the 2018 Proxy Process Roundtable.[57] As part of these events, many comment letters were submitted to the SEC. Of particular import, I believe, was the letter submitted by Ken Bertsch, the Executive Director of the Council of Institutional Investors (CII), to the Investor Advisory Committee. In his letter, Mr. Bertsch strongly and rightfully advocates for the SEC to facilitate the usage of blockchain technology in the proxy voting process.[58]

I agree with Mr. Bertsch that "[i]f deployed properly, blockchain-based proxy voting could protect investor privacy while enhancing:

- **Timeliness**—The dissemination of materials, process of voting, and reporting of results occurs immediately and simultaneously when conducted on the blockchain.
- **Accessibility**— The blockchain represents a technological advancement that improves the accessibility of the proxy voting process to all shareholders, large and small, potentially improving participation rates.
- **Accuracy**— The blockchain utilizes a gatekeeper to allocate and authenticate votes, and the technology itself immutably tabulates votes as they are cast.
- **Certainty**— Shareholders can achieve end-to-end confirmation on the

---

53 *Id.*

54 *See* H.R. 4173 – Dodd-Frank Wall Street Reform and Consumer Protection Act, 111th Cong. (2010) (enacted), *available at* https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf.

55 *See e.g.*, Chairman Jay Clayton, Remarks at the Economic Club of New York (Jul. 12, 2017), *available at* https://www.sec.gov/news/speech/remarks-economic-club-new-york.

56 *See* SEC Release No. 33-10531, *Investor Advisory Committee Meeting* (Aug. 17, 2018), *available at* https://www.sec.gov/rules/other/2018/33-10531.pdf.

57 In his statement last July announcing that the SEC staff would be holding a roundtable on proxy issues, Chairman Clayton noted that he was asking the staff to consider "the extent to which relatively low retail investor participation should be of concern and should inform analysis of existing regulation." *See* Chairman Jay Clayton, "Statement Announcing SEC Staff Roundtable on the Proxy Process,' July 30, 2018, *available at* https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process.

58 In full disclosure, I am a member of the Board of Directors of Symbiont, which is the market-leading smart contracts platform for institutional applications of blockchain technology, reflecting my long interest in the promise of this new technology.

blockchain since it records the executed voting instructions.

- **Cost-effectiveness**— We believe a blockchain-based system in the long run will be substantially less expensive than the current system by eliminating certain delays, frictions, and opacity."[59]

The benefits of blockchain technology will not be limited to institutional investors. As I discussed earlier, retail investors face their own unique challenges when exercising their proxy voting rights, and blockchain technology can alleviate many if not all of these challenges.

* * *

In closing, I want to thank the Committee for holding this important hearing and inviting me to speak with you today. I firmly believe that meaningful reforms can be made to the proxy process which will have salutary effects for investors and our capital markets more broadly, and I would welcome the opportunity to contribute to those efforts if there is any additional way I can be helpful to the Committee. Thank you.

[59] *See* Ken Bertsch, Remarks to the SEC Investor Advisory Committee (Sep. 13, 2018), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac091318-opening-remarks-ken-bertsch.pdf.

PREPARED STATEMENT OF MICHAEL GARLAND

ASSISTANT COMPTROLLER FOR CORPORATE GOVERNANCE AND RESPONSIBLE INVESTMENT, OFFICE OF THE NEW YORK CITY COMPTROLLER SCOTT STRINGER

DECEMBER 6, 2018

Good Morning, Chairman Crapo, Ranking Member Brown, and Members of the Committee. My name is Michael Garland and I am the Assistant Comptroller for Corporate Governance and Responsible Investment in the Office of New York City Comptroller Scott Stringer. Comptroller Stringer serves as a trustee to four of the five New York City Pension Funds and as the investment advisor and custodian to all five funds, which collectively have more than $200 billion in assets under management and a long history of active share ownership on issues of corporate governance and sustainability. It is an honor to be invited to provide this Committee with our perspective on important matters of shareowner responsibility.

The NYC Pension Funds (or "NYC Funds") together constitute a system made up of five independent public pension funds that provide retirement security to more than 700,000 of the City's active and retired teachers, police, firefighters, school employees, and general employees. Each of these constituencies has member representatives on the board of its respective fund.

With an average retirement benefit of $38,000 per year, it is likely that many of our members only participate in the capital markets through their role as pension fund beneficiaries. Our members are true Main Street investors, as opposed to a group using that name that represents the interests of company managers.

The NYC Pension Funds make up the fourth largest public pension system in the United States. We are long-term share owners of approximately 10,000 public companies around the world, including more than 3,000 U.S. companies.

Because of our long-term investment horizon, and the fact that we allocate more than 80 percent of the funds' investments in U.S. public equity through passive index strategies, we cannot readily sell shares in a company when we have concerns about the company's performance, board composition and quality, management, executive compensation, workplace practices or management of risks, including those related to climate change.

In these instances, the only way we can protect and create long-term shareowner value is to be an active owner of our portfolio companies by exercising our legal rights as shareowners. We (1) actively vote our proxies at each portfolio company, and (2) actively engage our portfolio companies, mainly through shareowner proposals and dialogue ensuing from those efforts, in order to promote sound corporate governance and responsible and sustainable business practices. In fact, over the last 30 years, the NYC Pension Funds have been the most prolific filer of shareowner proposals in the Nation.

As long-term owners, we expect companies to create long-term, sustainable value. We push them to address a range of environmental, social and governance risks that are fundamental to ensuring long-term profitability. This is part of our fiduciary duty as long-term shareowners.

We believe sound corporate governance and sustainable business practices—the latter including responsible labor, human rights and environmental practices—are fundamental to creating and protecting long-term shareowner value and sustainable economies.

The link between environmental, social and governance factors (ESG), on the one hand, and risk management and long-term value creation on the other, is supported by a growing body of empirical research, including an important study from Harvard Business School in 2011.

The study tracked the performance of 180 U.S. companies for 18 years and found that that "High Sustainability" companies outperformed "Low Sustainability" companies in terms of both stock market performance and profitability. According to the study, High Sustainability companies are those that embrace corporate policies related to the environment, their employees, community, products, and customers.

Our capacity to fulfill our proxy voting and engagement responsibilities to our beneficiaries depends heavily on (1) the timely receipt of expert, independent proxy research, and (2) our longstanding ability to submit shareowner proposals and to cast votes on proposals submitted by other shareowners, regardless of their size or sophistication (or whether institutional or retail).

The NYC Funds have been filing shareowner proposals and voting our own domestic proxies for more than 30 years.

Mr. Chairman, it is an honor therefore to be invited to provide this Committee with our perspective on (1) the role of proxy advisory firms, their involvement in the voting process and their current regulatory treatment; (2) the shareowner proposal process; and (3) the level of retail shareowner participation, its causes and whether the relatively low level of retail participation compared to institutional investors is cause for concern.

The remainder of my testimony will address each of these topics in order.

Proxy Advisors

With respect to proxy advisory firms, we oppose any additional U.S. Securities and Exchange Commission (SEC) actions that would compromise the independence of research, reduce the amount of time we have to review research aimed at voting at that company's annual meeting, or that would otherwise impose additional costs on our participants and beneficiaries in terms of either added burdens on our staff resources or additional compliance costs imposed on our advisors, which we, as paying clients, would ultimately bear.

While proxy advisory firms have been the subject of vocal criticism, I find it remarkable the impetus for onerous regulation of those firms is coming from those who are the subject of the analysis—particularly board members, corporate executives and their lobbying organizations—rather than from the institutional investors who pay for the research services. To the extent that there are concerns on the quality of proxy advisory firm research, that is our problem as investor clients. Many of those who are the subject of the proxy analysis do not like to be criticized and receive negative vote recommendations, so they are reportedly lobbying aggressively and inappropriately to insert themselves between the proxy advisers and the clients of those advisors.

The chief allegation of these lobbyists is that proxy advisor clients "automatically follow" proxy advisor recommendations and therefore the proxy advisors have too much influence. This argument was reflected in the testimony before this Committee last June by Thomas Quaadman of the U.S. Chamber of Commerce. The Chamber and similar lobbyists apparently seek to sow seeds of doubt about the capabilities of institutional investors to exercise their own judgment. The unfounded suggestion is that when it comes to voting proxies, which are considered plan assets under relevant fiduciary law, sophisticated institutional investors—whose job is to manage billions of dollars of investment capital—are like lemmings, blindly following the recommendations of proxy advisors in our proxy vote decisionmaking. This does a great disservice and I want to disabuse Committee Members of the notion that the argument of undue influence has merit.

Although Institutional Shareholder Services (ISS), the largest proxy advisory firm, recommended voting against say-on-pay proposals at 12.3 percent of Russell 3000 companies in 2018 (through November 1), only 2.4 percent of Russell 3000 companies received less than majority shareowner support on their say-on-pay proposals. According to Proxy Insight, which analyzes the voting records and policies of over 1,800 global investors and is the world's leading source of information on global shareowner voting, "the number of investors delegating their entire policy and voting to a proxy voting advisor is actually very low—from a sample of 1,413 investors, 75 percent have their own dedicated proxy voting policy representing a significant 92 percent of the assets under management." According to ISS, 85 percent of its top 100 clients use a custom voting policy.

The NYC Funds are among the proxy advisor clients that use custom policies. In our case, we have one policy that applies specifically to the U.S. market, which we first adopted in 1987. We have a second set of policies, adopted later, that apply to non-U.S. markets. While we have been voting our own U.S. proxies for more than 30 years, just this year the Comptroller's Office took back voting control of our entire global portfolio from our outside investment managers. Both policies, which are updated regularly, establish voting principles and positions on a broad range of issues, consistent with our views on how best to maximize long-term shareowner value.

I would like to provide the Committee with a window into our proxy voting process and the essential role that proxy advisors play in enabling institutional investors like us to comply with our fiduciary duty to vote proxies.

Like other institutional investors with custom policies, we use the research we receive from both of our proxy advisors as a critical inputs into how we apply our own guidelines. The specific proxy voting recommendations from the proxy advisors are entirely irrelevant to our process. In fact, as I will discuss in a moment, there is little correlation between their recommendations and our votes on executive pay, perhaps the most sensitive and contentious issue from the issuers' perspective (and likely the most important element leading CEOs and their representatives to seek onerous regulation of proxy advisors).

For the year ending June 30, 2018, our office cast 71,000 individual ballots at 7,000 shareowner meetings in 84 markets around the world, each market with its own governance norms and matters subject to shareowner voting. Consistent with our commitment to transparency, all of our proxy voting decisions are available on our website for our participants and beneficiaries, and our portfolio companies, to review.

During the peak of U.S. proxy season, which runs from April to the end of June, the number of meetings and votes is very large, putting a premium on having a high-quality, efficient process, to which the proxy advisory firms are indispensable. In the U.S. market, every ballot item, including each management and shareowner proposal, is individually reviewed and voted by our voting staff. We have five full-time staff dedicated to proxy voting during peak season, and our least-tenured investment analyst has 12 years' experience applying the NYC Funds' domestic proxy voting guidelines. All votes are cast according to our own guidelines irrespective of the proxy advisors' voting recommendations. Given the volume of annual meetings, and the complexity of company proxy disclosures, particularly with respect to executive compensation, our ability to apply our own guidelines rests in large part on the timely receipt of the independent, expert research we receive from our two proxy advisors (presently ISS and Glass Lewis).

Much of the information we obtain from the advisors' research reports is available in company proxy statements. But different companies present much of the important information in different ways and in various places. Just as our investment advisors rely on intermediaries like Bloomberg and FactSet to organize data from company disclosures, we rely on proxy advisory firms to pull information into a consistent format that permits quick reference to comparable data. Our ability to locate and calculate the necessary data points without this research would impose an unreasonable burden on the investment analysts who vote our proxies.

In addition to organizing and presenting in a uniform way information that is already somewhere in the proxy statement, the proxy advisors provide independent value-added analysis, such as peer group comparisons for executive compensation and total shareowner returns, the robustness of hedging and pledging policies, board gender diversity by percent—all of which are required to apply our guidelines. I would note that many company complaints of "inaccuracies" are that the proxy advisors use their own frameworks, rather than those of the company involved, to analyze issues (*e.g.,* ISS and Glass Lewis have their own definitions of director independence, leading to multiple company complaints of "inaccuracy" because the analysis does not parrot the company-favored definitions).

As an example of our independence, while the NYC Funds voted against say-on-pay at 25.4 percent of our U.S. portfolio companies for the year ending June 30, 2018, ISS only recommended against say-on-pay at 16.7 percent of these same companies.

We recognize our responsibility to vote proxies with diligence and integrity, and in the best long-term interests of our participants and beneficiaries. We do not want company management interposed between us and our research service providers, and this is even more true if it involves additional cost and delay, giving us less time for our due diligence on each proxy vote.

Shareowner Proposals

In our experience, as both a proponent and proxy voter, the shareowner proposal process is an essential and cost-effective tool for investors to protect and enhance value by aggregating and expressing their views to management, boards and other shareowners on major governance issues, corporate policies and important and emerging risks and opportunities. The NYC Funds have used shareowner proposals to prompt portfolio companies to constructively engage on specific concerns in ways that benefit the investing public.

Critics of shareowner proposal rights are seeking to remedy problems that do not exist. For example, critics of shareowner proposals claim that such proposals are deterring companies from going public, and thereby distorting our capital markets. This claim is highly implausible.

Proposals generally are nonbinding, and the average Russell 3000 company can expect to receive a proposal once every 7.7 years. Most proposals go to larger, established companies.

The notion seems to be that a company would forgo the benefits of efficient public equity markets to avoid the possibility that, sometime in the next decade or so, a shareowner might submit a nonbinding proposal to (for example) ask for improved disclosures around climate risk. This claim too is simply not plausible.

U.S. public equity markets are efficient, broad and deep. It is true that private equity markets also are larger and more efficient than in the past, and that some new economy companies have less need for capital than companies that emerged in earlier years, and can gain high valuations without needing to go to public markets. But that has nothing to do with shareowner proposals.

Outside investors (in both publicly held and private companies) want some means to protect their interests, and to hold management accountable. For public companies, that means providing outside shareowners with certain rights, including the right to file shareowner proposals, along with other regulatory and disclosure requirements that are the cost of admission to public markets, where companies have a dispersed shareowner base.

The NYC Funds have a proud record of engaging our portfolio companies on a broad range of environmental, social, and corporate governance issues, and thereby working to enhance long-term shareowner value, often through shareowner proposals. Our funds have filed more than 1,000 shareowner proposals, almost certainly more than any other institutional investor in the world, with a record dating back 30 years. And our shareowner proposal initiatives have led to significant market changes.

Among important changes that the NYC Pension Funds' shareowner proposals have helped achieve over the last 30 years (and often working in parallel with other institutional investors):

- Substantial independent majorities on boards of directors
- Enhanced standards of independence for members of company audit and compensation and nominating committees
- Strengthened policies to enhance board diversity
- Enhanced company disclosures on board composition and skills
- Annual election of all directors
- Proxy access rights
- Majority vote standards in election of directors
- Shareowner advisory votes on executive compensation
- Effective clawback policies
- Company disclosure of corporate lobbying and political spending
- Emphasis on performance-based awards in executive compensation
- Company policies prohibiting discrimination based on sexual orientation or gender identity

A particularly good example of market change from shareowner proposals relates to "proxy access"—that is, a mechanism to permit shareowners to include their nominees on the company proxy card for a minority of board seats under certain circumstances. In 2014, Comptroller Stringer and the NYC Funds launched the Boardroom Accountability Project, a campaign to implement proxy access on a company-by-company basis in the U.S. market using shareowner proposals.

Proxy access had long been a top priority for the NYC Pension Funds and other institutional investors. We applauded in 2003 when the SEC first proposed a proxy access rule in response to board failures at Enron and WorldCom. The SEC in 2009 again proposed a proxy access rule as a key response to the governance failures that contributed to the financial crisis of 2008. As authorized by the Dodd-Frank Act of 2010, the SEC enacted a proxy access rule in August 2010. The rule provided shareowners that collectively held 3 percent of a company's shares for at least 3 years the ability to nominate director candidates representing up to 25 percent of the board using the company's proxy materials. In September 2010, however, the Business Roundtable (BRT) and U.S. Chamber of Commerce successfully challenged the proxy access rule in Federal court. While the BRT and the Chamber opposed a universal rule, they implicitly endorsed the kind of private ordering they now oppose, and we called their bluff with our shareowner proposal effort.

Today, largely as a result of the Boardroom Accountability Project, approximately 540 U.S. companies, including 70 percent of S&P 500 companies, have enacted proxy access bylaws with terms similar to those in the vacated SEC rule, up from only six companies in 2014 when we launched the project.

In July 2015, economic researchers at the SEC released a study that analyzed the public launch of the Boardroom Accountability Project and found a 0.5 percent increase in shareowner value at the first 75 firms that received proxy access shareowner proposals from the NYC Funds. (See *http://www.sec.gov/dera/staff-papers/working-papers/24jul15__bhandari__public-vs-private.html.*) The SEC staff's findings were consistent with a 2014 CFA Institute study that found that proxy access on a market-wide basis has the potential to raise U.S. market capitalization by as much as 1 percent, or $140 billion.

As another example, the NYC Funds won significant change on company clawback policies, making use of shareowner proposals. Motivated by the small number of top executives held accountable for the excessive risk taking and compliance failures that led to the global financial crisis, the NYC Funds have fought for strong policies to enable boards at many major banks to claw back compensation from senior executives responsible for egregious misconduct that causes financial or reputational harm to their companies. In 2013, in response to a shareowner proposal, we successfully negotiated this enhancement to Wells Fargo's clawback policy. It was that policy that then enabled the Wells Fargo board of directors to announce in September 2016 that it would recoup $60 million from two senior executives in order to hold them financially accountable for the fake account scandal that involved the loss of jobs by 5,300 lower-level employees and cost Wells Fargo $185 million in fines and penalties.

Rule 14a–8 and the No-Action Process

SEC Rule 14a–8—which governs the shareowner proposal process—is largely effective, and is based on sound analysis of costs and benefits. Adjudication through court proceedings are substantially more expensive for all parties than the no-action process. We know this from experience, as we usually are satisfied with the SEC no-action process on our shareowner proposals (and have usually accepted rulings against our proposals), but on occasion have been moved to go to court when we believed an SEC staff decision was not warranted.

The 13 permitted exclusions reflect the SEC's determination as to what issues are or are not important enough to shareowners as a whole to warrant giving shareowners a vote. Thus, if a shareowner who meets the holding requirements wishes to present a topic that surmounts the 13 enumerated bases for exclusion, there is a benefit to all shareowners in terms of being able to have a say on what is, by definition, a policy matter affecting their interest as shareowners.

While the SEC has generally applied the rules fairly, there have been instances in which the SEC reversed precedent unfairly and to the significant detriment of investors, sometimes prompting the NYC Funds to seek legal recourse.

The first such instance was in 1992, when the New York City Employees Retirement System (NYCERS, one of the five NYC Pension Funds) filed a shareowner proposal asking Cracker Barrel to adopt a policy of nondiscrimination based on sexual orientation (the company had a policy against hiring gay employees). The SEC not only permitted the company to omit the proposal from its ballot because it dealt with "ordinary business," but also set a new standard whereby employment-based shareowner proposals would "always be excludable by corporations." NYCERS challenged the decision in court. While the lawsuit was unsuccessful (NYCERS lost on appeal), the resulting investor outcry later prompted the SEC to reverse its position, paving the way for investors to challenge workplace discrimination and address employment practices in shareowner proposals.

Today, largely in response to hundreds of shareowner proposals submitted by the NYC Funds and other investors, nearly 92 percent of Fortune 500 companies have nondiscrimination policies protecting employees on the basis of sexual orientation, and 82 percent include gender identity in those policies. A 2016 analysis by Credit Suisse found that 270 companies that provided inclusive LGBTQ work environments outperformed global stock markets by 3 percent for the previous 6 years.

Together with proxy access, this is among the NYC Funds' signature shareowner initiatives in terms of changing market practice.

Just as the SEC's Cracker Barrel decision threatened to unfairly and permanently exclude shareowner proposals on employee-related issues, last year's decision by the SEC to permit EOG Resources to exclude a proposal relating to greenhouse gas (GHG) emissions threatens to similarly undermine investors' ability to file proposals addressing fundamental risks related to climate change. The proposal would have required EOG to "adopt company-wide, quantitative, time-bound targets for reducing greenhouse gas emissions and issue a report, at reasonable cost and omitting proprietary information, discussing its plans and progress toward achieving these targets." The SEC staff found exclusion appropriate on the grounds that the proposal sought "to micromanage" the company, despite the broad language in the proposal simply seeking the use of goals, as used by many other companies (more than 60 percent of Fortune 100 companies already set GHG emission targets). This was a sharp reversal of earlier SEC views on climate change proposals.

In 2018, the NYC Funds requested that six additional companies include nearly identical resolutions in their proxy solicitation materials. The proposal was withdrawn at four of the companies, with three agreeing to substantially implement the proposal.

We plan to file similar proposals for 2019. Already though, one recipient of that proposal, perhaps feeling emboldened by last year's EOG no-action letter, has sought no-action relief from the SEC on the grounds of "micromanagement."

I would like to address two elements of Rule 14a–8 that have received particular attention in recent months: the ownership threshold (currently $2,000 in shares or 1 percent of shares, whichever is lower) and voting support thresholds to resubmit a proposal.

Ownership threshold: There was no ownership threshold (other than ownership of at least one share of stock) until 1983, when the SEC began requiring that the proponent(s) have held at least $1,000 in shares continuously for at least 1 year. The SEC raised this threshold to $2,000 in 1998, more or less in line with inflation in the intervening period. The SEC's view in adopting a threshold was that retail and other smaller investors should have access to use of shareowner proposals, but with some minimal level of ownership.

In our view, shareowners of any size should have the opportunity to use the shareowner proposal mechanism. Large institutional investors do not have a monopoly on good ideas. New York City pension funds supported about 77 percent of shareowner proposals in 2018, many from smaller investors including retail shareowners.

Section 844 of the Financial Choice Act, approved by the U.S. House of Representatives in 2017, includes a provision that would dramatically increase the ownership threshold, and require investors to have held a minimum of 1 percent of an issuer's voting securities for at least 3 years. If this had applied in the past, it would have eliminated all or nearly all shareowner proposals that have ever been submitted. For example, despite being among the largest pension investors in the world, NYC Funds rarely hold more than 0.5 percent of any individual company, and most often hold less. As a result, the Choice Act would effectively prevent our funds entirely from participating in the shareowner proposal process. To submit a shareowner proposal today at Microsoft or Apple, given share prices at the end of November, would have required ownership of at least $85 billion in shares at each company, far more than the $1.6 to $2.2 billion we currently have invested in each of these two companies.

Keith Higgins, the former director of Corporation Finance at the SEC, said in 2018: "How do you ever determine the 'right' level of ownership that should trigger the right to cause the company to include a shareowner proposal in its proxy statement? $2,000 seems low—but what is a better number? A February memo from the House Financial Services Committee suggested modernizing the threshold for inflation, but that is unlikely to have any meaningful impact." (An adjustment for inflation would put the threshold at about $3,000 in 2018 dollars.)

Resubmission thresholds: In 1948, the SEC first set a resubmission threshold, providing that a proposal that failed to earn at least 3 percent support in a year could be excluded from company proxy materials the next year. In 1954, the SEC set the current rule, providing for exclusion if a proposal did not earn at least 3 percent support the first year it is voted on, 6 percent the second year and 10 percent the third and subsequent attempts within 5 years. Attempts to raise the thresholds modestly in 1983 and drastically in 1997 failed, in 1997 because of overwhelming investor opposition that led the SEC to conclude that higher thresholds just did not make sense.

There is good reason for keeping resubmission thresholds relatively low. It can take many years, and different approaches and iterations, to build investor support for a shareowner proposal. The proposal for a sexual orientation nondiscrimination policy at Cracker Barrel received only 14 percent of the vote when it was first on the ballot in 1993. Similar proposals received less than 10 percent of the vote into the early 2000s, but by 2011, the NYC Funds received a 62 percent majority vote on such a proposal at KBR. Similarly, proposals for annual election of all directors, increased board diversity, and better disclosure on environmental impacts and risks all started out with limited support that grew substantially over the years.

Moreover, a proposal with limited support in a given year can become highly important if circumstances change. In 2007, a nonbinding shareowner proposal for an independent chair at Bank of America won only 16 percent support. Two years later, an unusual binding proposal for an independent chair was approved by Bank of America shareowners, after the company's share price had declined more than 90 percent in a short period of time during the financial crisis. That proposal became a key element in expression of shareowner views on changing leadership at the bank, without the necessity or disruption of a hedge fund activist campaign to elect a new board majority. While not diminishing regulatory influence in improving Bank of America governance, I would argue that that successful shareowner proposal, which received such limited support 2 years earlier, was critical in evolutionary change that built a much better, more stable bank that was responsive to shareowners as well as regulators.

To highlight another concern, the SEC resubmission rule applies broadly to proposals "on the same subject matter." A proxy access proposal at Netflix received support from 4.4 percent of the vote in 2013. From 2015 to 2018, Netflix shareowners annually approved a different NYC Funds' proxy access proposal—advocating different eligibility requirements—that would have been excluded if thresholds had been raised. And recently, we have seen efforts to pre-empt proposals in a given year urging stronger policies on climate change by a group submitting a proposal to go in the opposite direction. With high resubmission thresholds, that kind of mischief-making would be encouraged on a broader scale as long as the SEC policy refers to "the same subject matter" rather than "the same proposal."

The Netflix case points to another concern: the playing field is tilted in favor of management when shareowners propose change. The fact that Netflix has refused to implement multiple shareowner proposals receiving majority votes, and challenges to shareowners in submitting binding proposals of the sort used at Bank of America in 2009, shows this is not an even playing field, as does the fact a company is unlimited in the length it can use to oppose a proposal, while the shareowner proponent is limited to 500 words; corporate management can call on company resources to hire counsel to pursue no-action requests, while the proponent engages in that debate at her own cost; and management has access to preliminary voting tallies, which can help management organize its effort when there is a close vote, while the shareowner proponent now has access to such tallies only with permission of management.

Finally, we need to recognize that a significant subset of U.S. companies provide insiders with special voting rights that make the current resubmission thresholds effectively quite high, as they are based on "votes" and not "shares." At Facebook this year, a shareowner proposal requesting that the board establish a risk oversight committee received support from 11.6 percent of votes, but that appears to represent 34.2 percent of shares held in the publicly traded share class (that is, setting aside the super-voting shares with 10 votes per share held almost completely by insiders). Another proposal requested a report to shareowners on management of risks posed by content management policies (including election interference, fake news, hate speech, sexual harassment and violence) to the company's finances, operations and reputation. That proposal was supported by 10.2 percent of votes, but apparently our votes were among the 30.0 percent of shares held in the publicly traded share class that voted for the proposal.

While Facebook minimized the need to improve risk management, others would point to the substantial loss of shareowner value since the company's 2018 annual meeting as validating the concerns of a significant portion of outside shareowners. It would be unfortunate if resubmission thresholds ruled shareowner proposals on risk management at Facebook out of bounds for the next several years.

Retail shareowner participation

All shareowners regardless of their ownership stake, should have the opportunity to fully exercise the rights of share ownership, casting proxy votes consistent with their investment preferences and objectives, and submitting shareowner proposals.

Retail shareowner participation in proxy voting has fallen in recent years. According to Broadridge, retail voting participation averaged 28.4 percent for the 10 years ending June 30, 2017, compared to over 90 percent for institutional shareowners. While encouraging retail shareowner participation is commendable, it may be that some retail shareowners prefer to abstain from voting so that they can defer to the corporate governance expertise of institutional investors who have a fiduciary duty to vote. One trend is apparent from the data. The recent decline in retail voter participation is directly correlated to companies choosing to eliminate paper mailings of proxy materials as a cost savings measure. Retail shareowners are twice as likely to vote when they receive paper proxy materials relative to e-delivery or notice and access mailings, illustrating that technology-based solutions can have unintended consequences . For this reason, the electronic delivery of proxy materials should be opt-in, not opt-out.

We should encourage efforts like CorpGov.net, FundVotes, and Stake PBC that in various ways seek to foster retail voting and participation in the shareowner proposal process. Some other proposals on the table, such as client directed voting, whereby a shareowner could choose to automatically vote with management, are potentially problematic. Such a system would only be democratic if retail shareowners are given a genuine choice in who would cast their votes.

Absent genuine choice, client-directed voting would simply be a form of "robo-voting" for management. It is curious that some of the same groups who are advocating for client-directed voting are sounding alarms that some institutional investors may follow vote recommendations from independent, expert proxy advisors.

Conclusion

In summary, I would argue that the rights of investors to vote proxies, consistent with our investment objectives and preferences as informed by the advice of our expert advisers, and to constructively engage our portfolio companies using shareowner proposals are the kind of system of property rights that Nobel Prize winning economist Milton Friedman argued are fundamental to the efficient functioning of a Capitalist economy. Friedman also argued that the proper role of Government should be to protect and enforce property rights. We oppose any SEC actions that would infringe on these fundamental investor rights, which in their present form have served investors and market participants well.

Thank you again for the opportunity to testify today. I commend the Committee for holding this hearing and welcome your questions.

PREPARED STATEMENT OF THOMAS QUAADMAN

EXECUTIVE VICE PRESIDENT, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

DECEMBER 6, 2018

> The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as State and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.
>
> More than 96 percent of Chamber member companies have fewer than 100 employees, and many of the Nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.
>
> Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—*e.g.,* manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 States.
>
> The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Chairman Crapo, Ranking Member Brown, and Members of the Committee on Banking, Housing and Urban Affairs: my name is Tom Quaadman, Executive Vice President of the Center for Capital Markets Competitiveness ("CCMC") at the U.S. Chamber of Commerce ("Chamber"). Thank you for the opportunity to testify today regarding the rules governing the U.S. proxy system and potential regulatory changes that we believe must be implemented to modernize our capital markets.

Over the past several years, the Chamber has put forward a number of reports and recommendations to improve corporate governance in the United States and to make the public company model more attractive to growing businesses. These reports have included:

- 2013: *Best Practices and Core Principles for the Development, Dispensation, and Receipt of Proxy Advice,* a report that helped kick-start an important debate over the broken proxy advisory system in the United States;
- 2014: *Corporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation,* a report that included two dozen specific recommendations to modernize the SEC's disclosure regime;
- 2017: *Essential Information: Modernizing Our Corporate Disclosure System,* which emphasized the importance of the longstanding "materiality" standard for corporate disclosure; and

- 2017: *Shareholder Proposal Reform: The Need to Protect Investors and Promote the Long-Term Value of Public Companies,* which outlined seven recommendations on how to fix the outdated shareholder proposal system under Rule 14a–8 of the Securities Exchange Act.

Earlier this year, the Chamber—along with seven other organizations—issued a report entitled *Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public,* which included 22 recommendations that would expand upon the success of the 2012 Jumpstart our Business Startups (JOBS) Act. Many of these recommendations have also been incorporated into the JOBS And Investor Confidence Act, legislation that the Chamber strongly supports and which passed the House of Representatives in July by an overwhelming vote of 406–4.

The Chamber also appreciated the opportunity to participate in the recent Securities and Exchange Commission ("SEC" or "Commission") roundtable on the proxy process, which we believe was an important step toward reform. In advance of that roundtable, the Chamber offered the following reform recommendations to the SEC:

Proxy Advisory Firms

1) **The SEC should take steps to ensure that the guidance laid out in Staff Legal Bulletin 20 results in appropriate changes to compliance systems for proxy advisory firms and investment advisers, particularly in light of the recent withdrawal of the 2004 Egan-Jones and ISS no-action letters;**
2) **The SEC should enhance the conditions that a proxy advisory firm must satisfy to be exempt from the disclosure and filing requirements that apply to proxy solicitations;**

Shareholder Proposals

3) **The resubmission thresholds under Rule 14a–8 should be raised so that proponents must receive a meaningful level of support before resubmitting proposals that are overwhelmingly unpopular with investors;**
4) **The SEC should withdraw Staff Legal Bulletin 14H (CF) issued in October 2015;**
5) **Shareholder proposal proponents should be required to provide sufficient disclosure regarding their economic interests and objectives for any company in which they submit a proposal;**

Universal Proxy

6) **The SEC should abandon efforts to mandate the use of universal proxy cards during proxy contests; and**

Retail Investor Participation

7) **Initiatives to increase retail investor participation in the proxy process—such as client directed voting ("CDV")—should be pursued.**

Discussion

The Chamber has long advocated for policies that promote effective communication between public companies and their shareholders. Strong corporate governance is critical to promote the long-term performance of public companies and to enhance shareholder value.

Over the past 15 years, significant progress has been made to improve corporate governance and transparency. There has been a marked increase in the level and quality of communication amongst boards, management, and investors, and many asset managers have taken steps to enhance their due diligence regarding proxy voting.

However, a number of negative developments have also occurred during this time. Public companies and their shareholders are increasingly targeted through the proxy system and other means over issues that are unrelated to—and sometimes, even at odds with—enhancing long-term performance. Topics that should be reserved for the legislative and executive branches of government—including a variety of social and political issues that may not be directly correlated to the success of the company—are increasingly finding their way into proxy statements and being debated in boardrooms. This has created significant costs for shareholders and in many instances has distracted boards and management from focusing on the best interests of the company.

As the Manhattan Institute has pointed out, labor-affiliated pension plans have historically been the most active at advancing such agendas that do not correlate with long-term performance. From 2006–2015, labor-affiliated investors sponsored

32 percent of all shareholder proposals at the Fortune 250, many of which deal topics of a social or political nature.[1] Both the Department of Labor (DOL) Inspector General and the United States Court of Appeals for the D.C. Circuit have expressed skepticism as to whether the shareholder activism engaged in by labor-affiliated funds is actually connected to increasing share value.[2]

The DOL took action this year in order to ensure that Employee Retirement Income Security Act (ERISA) fiduciaries are making investments based on economic factors and not elevating environmental, social, or governance (ESG) impacts over returns. On April 23, 2018, the DOL issued Field Assistance Bulletin No. 2018–01 to provide further guidance on Interpretive Bulletins 2015–01 and 2016–01 relating to ESG investments and proxy voting in ERISA plans.[3] Specifically, FAB 2018–01 reiterates that "the Department has rejected a construction of ERISA that would . . . permit plan fiduciaries to expend trust assets to promote myriad public policy preferences. Rather, plan fiduciaries may not increase expenses, sacrifice investment returns, or reduce the security of plan benefits in order to promote collateral goals." This is an important step in order to ensure that fiduciaries are making investments in investors' best interests based on economic returns as the primary consideration.

FAB 2018–01 should also be viewed in the context of evidence that has also been put forth regarding shareholder activism and its impact on returns for public pension plans. A 2015 Manhattan Institute Report found that the social activism engaged in by certain public pension plan systems—such as the California Public Employee Retirement System (CalPERS) and the New York State Common Retirement System (NYSCR)—is actually correlated with lower returns for the plans.[4] In other words, public pension plan beneficiaries and taxpayers in such jurisdictions are actually harmed when the overseers of public pension plans emphasize social or political goals over the economic return of the plan.

Outdated SEC proxy rules have allowed motivated special interests to take advantage of this system to the detriment of Main Street investors and pensioners. The problems we face today have in part stemmed from a lack of proper oversight over proxy advisory firms and a failure to modernize corporate disclosure requirements. Activists have been able to hijack shareholder meetings with proposals concerning pet issues—all to the detriment of the vast majority of America's investors.

The deficiencies within the U.S. proxy system must also be viewed against the backdrop of the sharp decline of public companies over the past two decades. The United States is now home to roughly half the number of public companies than existed in the mid-1990s and the overall number of public listings is little changed from 1983. While the JOBS Act helped arrest that decline, too many companies are deciding that going or staying public is not in their long-term best interest. There is little doubt that the current proxy system—which disadvantages long-term investors and creates serious challenges for companies—has made the public company model less attractive. With fewer public companies come fewer investment opportunities for Main Street investors and fewer growth opportunities for the U.S. economy.

The public company model has been a key source of strength and growth which has made the United States economy the strongest and most prosperous in world history. When businesses go public, jobs are created and new centers of wealth are formed. During the 1980s and 1990s, stories of the Microsoft executive assistant or the UPS driver becoming a millionaire were not uncommon after a company went through the initial public offering ("IPO") process. A 2012 study done by the Kaufmann Foundation found that for the 2,766 companies that went through the IPO process between 1996 and 2010, employment cumulatively increased by 2.2 million jobs.[5] Other benefits also accrue to companies when they go public, such as revenue growth.

Activist campaigns, as well as routine proxy matters that companies deal with today, are also magnified by the outsized influence of proxy advisory firms. Two firms—Institutional Shareholder Services ("ISS") and Glass Lewis—constitute roughly 97 percent of the proxy advisory firm market, yet both are riddled with conflicts of interest, operate with little transparency, and are prone to making

[1] Manhattan Institute Proxy Monitor 2016 Report *https://www.manhattaninstitute.org/sites/default/files/pmr_2016.pdf.*

[2] *E.g. Business Roundtable & Chamber of Commerce of the U.S. v. SEC,* 647 F. 3d 1144, 1152 (D.C. Cir. 2011); Department of Labor OIG report "Proxy Voting May Not Be Solely for the Economic Benefit of Retirement Plans (March 31, 2011).

[3] *https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018–01.*

[4] Tracie Woidtke—Public Pension Fund Activism and Firm Value (September 1, 2015).

[5] Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996–2010.

significant errors in vote recommendations that jeopardize the ability of investors to make informed decisions in their best interests.

In addition, the economic interests of proxy advisory firms is not always aligned to ensure the firms are best equipped to research and understand the conditions of the companies they are rating. These factors combine to create an incentive system that does not prioritize accurate recommendations or to provide accountability throughout the rating process. The Chamber and many others have long called for greater oversight of this industry in order to better protect investors and maintain the competitiveness of our vibrant public markets.

These firms by some estimates can "control" up to 38 percent of the shareholder vote because some of their clients van automatically follow vote recommendations.[6] And according to ISS, the firm covers more than 20,000 companies around the globe, and executes 9.6 million ballots representing over 3.7 trillion shares. Such an unfettered role in the public capital markets demands an oversight function to ensure that investor returns are always a top priority.

The recent decision taken by the SEC staff to withdraw the 2004 Egan-Jones and ISS staff no-action letters ("2004 no-action letters") was an important step toward fixing a broken proxy advisory system.[7] These letters allowed investment advisers to outsource their fiduciary voting duties to proxy advisory firms, thus entrenching the position and influence of the firms. The letters also allowed investment advisers to rely on the general policies and procedures a proxy advisory firm had related to its own conflicts, instead of requiring the identification of specific conflicts related to a particular company. The unintended consequence of these letters was to allow conflicts of interest to proliferate in the proxy advisor system, and to further bolster the role and influence of the two dominant firms.

With the 2004 no-action letters now withdrawn, the SEC should take steps to ensure that the 2014 guidance laid out in Staff Legal Bulletin 20[8] ("SLB 20") will actually result in appropriate changes to compliance systems for proxy advisory firms and investment advisers. The conditions that a proxy advisory firm must satisfy in order to be exempt from the proxy solicitation rules should also be enhanced in order to address many of the concerns that have been raised over the years regarding proxy advisory firm recommendations and reports.

In addition to addressing proxy advisory firms, the SEC should implement reforms to the shareholder proposal process under Rule 14a–8 of the Exchange Act, and implement a Client Directed Voting ("CDV") framework that empowers retail shareholders by making it easier for them to participate in the proxy process. We also believe that the SEC should abandon its ill-advised 2016 proposal on universal proxy ballots.

SEC Roundtable

The November 15th SEC roundtable examined all aspects of the U.S. proxy system, including proxy voting and proxy "plumbing" issues, the shareholder proposal system, and proxy advisory firms. While many issues were laid on the table, we believe that the top priority for the SEC should be reforming the proxy advisory system.

As the Chamber pointed out in our November comment letter (see *https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/11/11.12.18-Chamber-Proxy-Roundtable-Letter.pdf?*) for the roundtable, we have long been concerned about the concentration, conflicts of interest, and lack of transparency in the proxy advisory system. ISS and Glass Lewis also have a significant level of influence over the manner in which public companies are operated. All of these factors harm our capital markets, impair capital formation, and discourage companies from going and staying public.

One key takeaway from the November 15th roundtable is that there is no uniform, baseline set of regulations or even standards that apply to proxy advisory firms. Just about every other market participant in the proxy process—brokers, banks, transfer agents, asset managers, public companies—are subjected to at least some type of regulatory oversight. The lack of an oversight regime for proxy advisory firms stands in stark contrast to past determinations made by the SEC and Congress regarding the need to oversee and regulate the proxy process for public companies.

---

[6] ISS 24.7 percent Glass Lewis 12.9 percent Source: Ertimur, Yicca, Ferri, Fabrizio, and Oesch. *Shareholder Votes and Proxy Advisors: Estimates from Say on Pay (February 25, 2013).*

[7] Statement Regarding Staff Proxy Advisory Letters—Division of Investment Management *https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters.*

[8] Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, June 30, 2014.

The roundtable also reinforced that the two largest proxy advisory firms view their roles and responsibilities very differently. ISS has chosen to register under the Investment Advisers Act and holds itself out as a fiduciary, stating that "we have a fiduciary obligation to our clients to provide advice that is in their best interest."[9] Glass Lewis, on the other hand, has chosen not to register at all with the SEC and therefore presumably does not view itself as a fiduciary.

Furthermore, ISS continues to operate a consulting business to issuers in addition to its core institutional investor business. ISS claims that such a business model is not a problem because of the way it manages conflicts, and claims the existence of a "firewall" between the two divisions. Glass Lewis, meanwhile, stated in a recent letter to Members of the Senate Banking Committee that "unlike ISS, Glass Lewis does not provide consulting services to issuers. *We believe the provision of consulting services creates a problematic conflict of interest that goes against the very governance principles that proxy advisors like ourselves advocate.*"[10] (Emphasis added).

We can think of no other area under the securities laws where two dominant market participants in the same industry operate under two completely different sets of rules and standards—with one of those participants choosing not to register with the SEC at all. While commenters will disagree as to the proper regulatory regime for proxy advisors, we think there should be broad agreement that allowing proxy advisory firms to choose their own regulatory model is not the right approach. From the Chamber's viewpoint, we believe that the business and regulatory models of both ISS and Glass Lewis are deficient, and would advocate that the SEC or Congress adopt baseline standards for proxy advisory firms to follow.

Congressional Action to Address Proxy Advisory Firms

In December 2017, the House of Representatives passed H.R. 4015, the Corporate Governance Reform and Transparency Act, bipartisan legislation which would require proxy advisory firms to register with the SEC and become subjected to a robust regulatory regime. The Chamber strongly supports this legislation as we believe it will provide for much needed transparency and oversight by requiring proxy advisory firms to disclose conflicts of interest, grant companies sufficient time to respond to voting recommendations, and require that firms demonstrate their capabilities to provide fair and accurate voting recommendations.

The Chamber also appreciates the work of Sens. Reed, Perdue, Tillis, Kennedy, Jones, and Heitkamp to introduce S. 3614, the Corporate Governance Fairness Act. This legislation would require certain proxy advisory firms to register under the Investment Advisers Act, and directs the SEC to conduct periodic inspections of firms. The SEC would also be required to submit a report every 5 years to the Senate Banking and House Financial Services Committee that evaluates the policies and procedures proxy advisory firms have to, amongst other things, manage conflicts of interest and avoid making false statements in vote recommendations. While the Chamber continues to evaluate this legislation, we believe such a bipartisan effort in the Senate demonstrates the broad belief that the status quo of the proxy advisory firm industry must be changed.

Recommendations

Proxy Advisory Firms

In 2013, the Chamber released a report, *Best Practices and Core Principles for the Development, Dispensation, and Receipt of Proxy Advice.* ("Chamber principles") The goal of this report was to improve corporate governance by ensuring that proxy advisory firms:

- Are free of conflicts of interest that could influence vote recommendations;
- Ensure that reports are factually correct and establish a fair and reasonable process for correcting errors;
- Produce vote recommendations and policy standards that are supported by data driven procedures and methodologies that tie recommendations to shareholder value;
- Allow for a robust dialogue between proxy advisory firms and stakeholders when developing policy standards and vote recommendations;
- Provide vote recommendations to reflect the individual condition, status, and structure for each company and not employ one-size-fits-all voting advice; and

[9] ISS Comment Letter for November 15 Roundtable.

[10] *http://www.glasslewis.com/wp-content/uploads/2018/06/Glass-Lewis-Response-to-May-9-2018-Chairman-Heller-Letter__0601__FINAL.pdf.*

- Provide for communication with public companies to prevent factual errors and better understand the facts surrounding the financial condition and governance of a company.

With the issuance of these principles, the Chamber sought to foster an environment where Government would encourage proxy advisory firms, public companies, and investors to work together in order to create a system of accountability and transparency that would build off other positive developments in corporate governance that have occurred in recent years. Importantly, since 2013 both Congress and the SEC have become interested in reform—the House Capital Markets Subcommittee held a hearing on the proxy advisory system in June 2013, and an SEC roundtable on the topic was held later that year.

Staff Legal Bulletin 20—issued in June 2014—implemented several concepts from the Chamber principles, and reaffirmed that enhancing shareholder value must be the primary consideration for proxy advisory firms when dispensing voting advice and for investment advisers when making proxy voting decisions. The guidance also reinforces the fact that the fiduciary duty of investment advisers permeates all aspects of the development and receipt of proxy advice. This was a positive action taken by the SEC that drew further attention to issues within the proxy advisory firm system.

Regrettably, notwithstanding the issuance of SLB 20 and the increased attention by the Chamber and others regarding the issues, it has become clear that many longstanding problems still remain. As mentioned previously, without proxy advisory firms having a fiduciary duty or an economic interest to the companies they are rating, there is very little incentive for these problems to resolve themselves given the proxy advisory firms' for-profit business model. Since 2015, the Chamber and NASDAQ have conducted an annual survey of public companies to better understand the experience that issuers have with proxy advisory firms during the proxy season. What these surveys have consistently found is that while incremental progress has been made in recent years, further action is necessary.

This year's survey (see *https://www.centerforcapitalmarkets.com/resource/2018-proxy-season-survey/*)—which was completed by 165 companies of varying sizes and across several industries—found that a lack of communication and concerns over the quality of vote recommendations remain two significant problems.

For example, when companies requested the opportunity to meet with a proxy advisory firm in order to discuss issues subject to shareholder votes, that request was denied 57 percent of the time. Companies also reported being given insufficient time to provide input both before and after a firm's recommendations were finalized, a problem compounded by "robo-voting" practices that lead to the automatic casing of large blocks of proxy votes in the immediate aftermath of the proxy advisory firms' recommendations. Some companies reported that 10–15 percent of their shares would automatically vote in line with an ISS recommendation, while others estimated that between 25–30 percent fell into that category. The amount of time granted to provide input ranged from 30 minutes to 2 weeks, with 1–2 days being the most common response. And only 39 percent of companies believe that proxy advisory firms carefully researched and took into account all relevant aspects of a particular issue for which it was providing a vote recommendation.

To help the Committee better understand some of the concerns over the quality of proxy advisory firm vote recommendations, attached to this testimony is a recent compilation of supplemental proxy filings made by companies during the 2016, 2017, and 2018 proxy seasons detailing issues they have run into with proxy advisory firms. The issues outlined in these supplemental proxies include difficulty in communicating with proxy advisory firms, issues with peer group selection, and in some cases outright errors made on behalf of the proxy advisory firms. It is also likely that these issues are only a small cross-section of the systemic problems associated with proxy advisory firms, as many companies likely do not file supplemental proxies.

This is an error rate of approximately 2 to 2.5 percent. But the error rate is much higher as many companies decide not to file a supplemental proxy. Such an error rate based upon the fiduciary responsibilities is not acceptable. Furthermore, an error rate of over 2 percent means that proxy advisory firms are failing to provide their clients with the decision useful information that they need to make proxy voting decisions. If the clients of advisory firms are not getting decision useful information then they are not meeting their fiduciary duty.

One of the complaints about process reforms is that it will impose costs upon the clients of proxy advisory firms. We agree with those concerns. However, an error rate of over 2 percent and failing to provide investors with decision investor information also adversely impacts return. Lower investor return will harm the retail clients of institutional investors to the tune of billions of dollars dwarfing any increased costs in process and regulatory compliance.

The Chamber also remains very concerned regarding the conflicts of interest that pervade both ISS and Glass-Lewis which can improperly influence voting recommendations. ISS continues to operate a corporate consulting business that provides advice to companies as to how they can achieve better corporate governance ratings. ISS's ownership of both a research division and a consulting arm—accepting fees from both the institutional investors who receive their proxy voting advice as well as the companies that are the subject of that advice—has rightly been a focal point of criticism over the conflicts inherent in this business model.

While Glass Lewis does not operate a consulting division, its ownership structure presents a different conflict of interest. Glass Lewis is owned by activist institutional investors—the Ontario Teachers' Pension Plan and the Alberta Investment Management Corporation. The Chamber has in the past brought to the attention of the SEC examples of how this ownership structure could result in tainted vote recommendations.[11]

While the lack of action to address these issues directly led to the congressional action referenced above, the SEC does not need to wait on Congress to act. There are actions the SEC can take based on its existing authority that would benefit investors by enhancing transparency and accountability in the proxy advisory industry.

SLB 20

In response to criticisms of proxy advisory firms raised by market participants, academics, Members of Congress, and others, SEC staff issued SLB 20 in June 2014. This guidance provides public companies, proxy advisory firms, and investment advisers with five principles to adhere to:

- Fiduciary duties permeate and govern all aspects of the development, dispensation, and receipt of proxy advice;
- Enhancing and promoting shareholder value must be the core consideration in rendering proxy-voting advice as well as making proxy voting decisions;
- The proper role of proxy advisory firms is to provide accurate and current information to assist those with voting power to fulfill their fiduciary duty and further the economic best interests of those who entrust their assets to portfolio managers;
- Clarifies the scope of portfolio managers' obligations to exercise a vote on proxy issues, and it emphasizes the broad discretion investment advisers have to refrain from voting on every, or even any, proposal put before shareholders for a vote; and
- In light of the direction provided, proxy advisory firms, portfolio managers, and public companies need to reassess their current practices and procedures and adopt appropriate changes necessitated by SLB 20.

There is an important nexus between the withdrawal of the 2004 no-action letters and the fact that SLB 20 remains in effect. At its core, SLB 20 emphasizes that, as a fiduciary, an investment adviser must exercise proper oversight over a proxy advisory firm when the adviser uses such firm's recommendations in deciding how to vote. This helps ensure that the adviser is sufficiently confident in the soundness of a recommendation that the adviser relies on when voting. The value of oversight is heightened where so many concerns have been raised about inaccurate information and conflicts of interest affecting proxy advisory firm recommendations. Accordingly, the SEC should take steps, such as Commission guidance, rulemaking, or a combination of the two, that will ensure that the guidance laid out in Staff Legal Bulletin 20 results in appropriate changes to compliance systems for investment advisers and, by extension, proxy advisory firms themselves.

Exemption from the Proxy Solicitation Rules

Under the Exchange Act, entities, including proxy advisory firms, which engage in a proxy "solicitation," are subject to various disclosure and filing requirements in accordance with the SEC's proxy rules. The SEC Divisions of Investment Management and Corporation Finance have explained in SLB 20 that the Commission generally has found that furnishing proxy voting advice, as a proxy advisory firm does, constitutes a solicitation. However, a proxy advisory firm may be able to rely

[11] See *e.g.,* Letter of May 30, 2012, to SEC Chair Mary Schapiro *http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/2012-5.30-Glass-Lewis-letter-release.pdf.*

on one or more exemptions to the proxy rule disclosure and filing requirements if the firm meets certain conditions.

In light of the many legitimate concerns that have been raised over the years about proxy advisory firm recommendations and reports, the SEC should enhance the conditions that a proxy advisory firm must satisfy to be exempt from the disclosure and filing requirements that apply to solicitations. The enhanced conditions would help ensure that a proxy advisory firm's failure to comply with the proxy rule disclosure and filing requirements does not unduly compromise the goals of transparency.

Specifically, to get the benefit of an exemption, a proxy advisory firm, should, at a minimum, have to:

- ensure that any recommendation that the firm makes is not based on materially inaccurate information or unsubstantiated assumptions, by requiring that the proxy advisor:
  - identify any information the firm is using in the analysis which is contested by the issuer or differs from the information disclosed by the issuer; and
  - include a written justification for why the issuer's disclosed information was not used
- adequately disclose and otherwise manage any conflicts of interest;
- provide an issuer with adequate time to meaningfully review a recommendation and, relatedly, the proxy advisory firm must accept engagement requests by the issuer before publishing a recommendation and require that the proxy advisory firm disclose the nature of the engagement;
- not proceed with any automatic voting of client proxies if a company contests an adviser's recommendation so that the client has an opportunity to review both the adviser's explanation and any additional information the company may choose to provide and can make its own fully formed voting decision;
- explain in sufficient detail the proxy advisory firm's methodologies and how the proxy advisory firm has adhered to or deviated from such methodologies in determining each recommendation as to an issuer, including the extent to which the firm has relied on the recommendations, analysis, or rankings of any third party and, if so, which ones;
- explain in sufficient detail the reason for the proxy advisory firm's peer group selection(s) if it has chosen to construct its own peer group in lieu of the issuer's, including a detailed description of the impact of the proxy firm's decision to change an issuer's peer group and how the analysis or resulting recommendation of an issuer's executive compensation program would have differed had the issuer's own peer group been used; and
- explain in sufficient detail why the proxy advisory firm has determined that any one-size-fits-all recommendations are appropriate given the particular facts and circumstances of the issuer and how the analysis or resulting recommendation would have differed had the issuer's own disclosed performance measures been utilized.

Shareholder Proposals

The current rules governing shareholder proposals are administered by the SEC under Rule 14a–8 of the Securities Exchange Act. For decades, the basic purpose of the shareholder proposal system was to allow investors to put forth constructive ideas on how to improve a company's governance and performance. The SEC often rightly took the position that proposals dealing with personal grievances, or those of a social or political nature, were not proper subjects to be considered or debated at annual meetings, largely because such proposals sought to advance idiosyncratic objectives rather than enhance the long-term performance of the company.

Unfortunately, the shareholder proposal system today has become dominated by a minority of special interests that exploit an outdated system in order to advance parochial agendas. According to the Manhattan Institute's Proxy Monitor report, 56 percent of shareholder proposals at Fortune 250 companies during the 2017 proxy season dealt with social or policy concerns.[12] And a small group of activists is responsible for a significant proportion of all shareholder proposals, a vast majority of which relate to governance matters—in fact, during 2017, just three individuals

[12] Proxy Monitor 2017: Season Review, available at *https://www.manhattan-institute.org/html/proxy-monitor-2017-season-review-10757.html.*

and their family members sponsored 25 percent of proposals submitted at the Fortune 250.[13]

In July 2017, the Chamber released a report, *Shareholder Proposal Reform: The Need to Protect Investors and Promote the Long-Term Value of Public Companies,* which outlined seven recommendations for how to improve Rule 14a–8. The most impactful of these recommendations would be to raise the "resubmission thresholds" which determine when a proponent is allowed to resubmit a proposal which previously garnered low support. In 2014, the Chamber along with eight other organizations also submitted a rulemaking petition calling on the SEC to raise the resubmission thresholds under Rule 14a–8.[14]

Current rules allow a company to exclude a shareholder proposal if it failed to receive the support of:

- Less than 3 percent support on the previous submission if voted on once within the previous 5 years;
- Less than 6 percent support on the previous submission if voted on twice within the previous 5 years;
- Less than 10 percent support on the previous submission if voted on three or more times within the previous 5 years.

Thus, a proponent can keep resubmitting a proposal even if nearly 90 percent of shareholders have rejected it on multiple occasions. Such a system forces the vast majority of investors—who are primarily concerned about the economic return of their investments—to bear the costs of having to deal with frivolous proposals year after year. It also creates significant distractions for the board and management of a company, which should focused on long-term performance.

We believe that, at a minimum, the SEC should raise the resubmission thresholds to levels that were first proposed by the Commission in 1997.[15] That proposal would have raised the resubmission thresholds from the current 3-percent-6-percent-10-percent system to a more reasonable 6-percent-15-percent-30-percent. Raising the thresholds would still allow retail and others shareholders to submit a proposal and have their voice heard, but would require that they receive a reasonable level of support before submitting it again in a subsequent year.

To help the SEC better understand the need to raise the resubmission thresholds, in October 2018 the Chamber released a report (*https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/10/CCMC_ZombieProposal_Digital.pdf)* on "zombie" shareholder proposals. A zombie proposal is defined as one which has been submitted at a company three or more times but has failed to receive majority support. The Chamber report highlights a recent thought leadership piece that examined 2,449 shareholder proposals submitted from 2001 to 2018 relating to special meetings, environmental and social, political and social, and human rights matters. According to this analysis:

- Only 5 percent of these types of proposals passed;
- Zombie proposals made up 32 percent of all failed proposals; and
- Out of the 2,449 total proposals examined, 723 were zombie proposals—almost a full 30 percent.

Importantly, had the SEC implemented a new threshold rule of 6 percent–15 percent–30 percent prior to the period examined, only 27 percent of zombies would have been eligible for a fourth year on company ballots. In other words, more reasonable thresholds would in many cases have protected shareholders and companies from the costs and distraction associated with having to register their opposition on multiple occasions.

In addition to raising the resubmission thresholds, two important reforms to Rule 14a–8 are necessary: The SEC should withdraw Staff Legal Bulletin 14H and require shareholder proponents to provide sufficient disclosure regarding their economic interests and objectives.

Staff Legal Bulletin 14H was issued in the wake of a January 2015 decision to suddenly reverse a previous SEC staff decision regarding a shareholder proposal at

[13] *Id.*

[14] Petition for Rulemaking Regarding Resubmission of Shareholder Proposals Failing to Elicit Meaningful Shareholder Support (April 9, 2014) Petition submitted by U.S. Chamber of Commerce, National Association of Corporate Directors, National Black Chamber of Commerce, American Petroleum Institute, American Insurance Association, The Latino Coalition, Financial Services Roundtable, Center on Executive Compensation, and Financial Services Forum.

[15] Proposed Rule: Amendments to Rules on Shareholder Proposals Release No. 34–39093 Sep 19, 1997.

Whole Foods. This bulletin ultimately limited the ability of companies to use an exemption under Rule 14a–8(i)(9) which allows for the exclusion of a proposal if it conflicts with one of the company's own proposals and has added a great deal of uncertainty to the no-action process. Although it significantly altered the utility of an exemption recognized by Rule 14a–8, Staff Legal Bulletin 14H was never considered or approved by the full Commission.

The SEC should also take steps to ensure transparency regarding the proponents of shareholder proposals. There is currently a gap between the information a company must provide to investors in its proxy statement and the information—or lack of information—that is provided by many shareholder proponents. This gap is particularly pronounced when proposals are submitted via proxy in whom the proponent nominally represents the true beneficial owner of the shares, yet owns no shares of its own. To level this playing field and protect investors, proponents should—at a minimum—be required to disclose:

- Personal information such as name and address;
- The number of shares that the proponent owns or has a right to acquire, as well as why the proponent acquired the shares and the objectives the proponent has with respect to the issuer;
- A description of any contracts or arrangements the proponent has with another person to provide any type of benefit in relation to the submission of the proposal;
- Whether the person has submitted the same or a substantially similar proposal to another issuer and the identity of such issuer(s);
- In cases where the person submitting the proposal is acting as a proxy or representative on behalf of someone else, the beneficial owner of the shares should be required to make similar disclosures; and
- The SEC should define what it means to "own" shares in the context of eligibility for submitting a proposal; this would help ensure that a proponent has an economic interest in the company.

We believe these are modest reforms to Rule 14a–8 that would protect against abuse of the system while still preserving the ability of retail investors to have their voice heard in corporate matters. Retail investors would retain the ability to bring forward a proposal at a company—or multiple companies if they feel it involves a pervasive issue—but would have to comply with basic transparency requirements and demonstrate that their idea can elicit a meaningful level of support.

Universal Proxy

In October 2016, the SEC proposed a rule that would mandate the use of a universal proxy ballot in contested director elections.[16] The proposal would ostensibly level the playing field for shareholders that do not attend a company's annual meeting. In reality, the mandated use of universal proxies would increase the frequency and ease of proxy fights for dissident shareholders and empower special interests at the expense of Main Street investors.

For decades, SEC rules have allowed a shareholder who is willing to commit the necessary resources to conduct a proxy contest to seek a change in board composition. If such a shareholder is able to nominate credible, qualified candidates that gain the support of other investors, the shareholder is sometimes able to alter the composition of the board. If shareholders wish to split their votes among a company's nominees and a dissident's nominees, they are able to attend the annual shareholder meeting in order to cast a vote. This longstanding system of voting for public company directors is well-understood by the market and has been the foundation for numerous orderly director elections over the years.

The mandated use of a universal proxy ballot would encourage proxy fights by either individual or small groups of shareholders who do not owe the same fiduciary duty to shareholders as the board of directors and management do. Such dissident shareholders are not bound by the company's corporate governance policies and may seek to nominate directors to advance their own parochial interests without regard to the broader best interests of the company and its shareholders as a whole. Following this reasoning, in rejecting Rule 14a–11 (the SEC's mandatory proxy access rule), the D.C. Circuit cited the SEC's failure to assess the risk of giving special in-

[16] Proposed Rule: Universal Proxy Release No. 34–79164; IC–32339, October 26, 2016.

terest groups new powers to pursue self-interested objectives rather than the goal of maximizing shareholder value.[17]

In addition to these fundamental flaws of a mandated universal proxy ballot, the Commission's proposing release contained some provisions that would further tilt the balance in favor of special interests. For example, dissident shareholders would be permitted to send proxy statements to shareholders representing only a majority of the voting power of shares entitled to vote in an election. Because the proposed rules would not require an insurgent to solicit all shareholders, it stands to reason that retail investors would be ignored, and the only investors solicited would be ones most likely to favor the dissident slate. A dissident could even satisfy this requirement by soliciting only a handful of a company's largest institutional investors. Such an outcome would be detrimental to the interests of investors as a whole, and particularly to retail investors who would be left without a voice.

To be clear, we do not object if private ordering leads individual companies voluntarily to elect to use a universal proxy card. Our objection is only to an SEC mandate on the subject. As such, we believe the SEC should abandon the universal proxy ballot rulemaking in its entirety, and instead focus on other areas of reform for the U.S. proxy system, which could be much more impactful in advancing the mission of the SEC.

Increasing Retail Investor Participation—Client Directed Voting

As the Commission noted in its announcement for the roundtable, retail investors have in recent years had very low participation rates in the proxy process relative to institutions, with 29 percent of retail shareholders voting their shares in 2018 (compared to 91 percent of institutional investors voting their shares). The Chamber has long been concerned that the failure to empower retail investors in the proxy process creates unequal classes of investors with differing abilities to provide input to public companies.

We continue to support implementation of the Client Directed Voting model ("CDV") as a means to boost retail investor participation. CDV involves a process by which a retail shareholder can provide advance voting instructions to an entity authorized to vote his or her shares, while retaining the ability to change voting instructions in the future. Adoption of the CDV model would provide an alternative to examining every individual proxy issue, and instead allow retail investors to establish standing instructions on proxy voting that are in line with their investment philosophy and strategy. Furthermore, advances in technology since CDV was last considered could likely alleviate some of the concerns originally raised, which the SEC is well suited to consider.

Allowing the use of a CDV model would give retail shareholders access to the same mechanisms used by many institutional shareholders who regularly provide standing proxy voting instructions. This innovative change could allow for greater retail involvement in the proxy process and create a more level playing field for all investors.

Conclusion

We appreciate the good work of the Senate Banking Committee in finding ways to improve the competitiveness of our Nation's capital markets. Reform of the U.S. proxy rules is a critical piece of encourage more companies to go and stay public, and we look forward to working with all Members of Congress and the SEC in order to modernize an outdated system.

[17] See *Business Roundtable v. SEC,* 647 F.3d 1144, 1152 (D.C. Cir 2011).

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNER FROM DANIEL M. GALLAGHER

I am happy to provide the following written answers to the additional questions submitted by Senator Warner. As requested by Chairman Crapo in his letter of January 3, 2019, I have repeated below each of Senator Warner's four questions, followed in each case by my answer.

As was the case with my testimony, the answers below are given in my personal capacity, including as a former Commissioner of the Securities and Exchange Commission. I do not speak for any employers or other associates, either past or present.

Q.1. This hearing is about the proxy process, which is a key way shareholders communicate their views on important issues to boards and companies. But it is not the only way that shareholders engage in a dialogue with boards and management.

Q.1.a. Can you describe what informal communication occurs between shareholders or a particular shareholder and the board or management?

A.1.a. Informal communications between shareholders and the directors and management of the companies in which they invest can occur throughout the year, often via email or phone calls or at investor conferences or individual investor meetings.

Q.1.b. What topics are frequently discussed, and who is involved in those conversations?

A.1.b. While the topics vary, common ones include corporate strategy, corporate governance and executive compensation. The participants from the company vary depending on the topic but often include a member of the company's investor relations team and other members of management. Some conversations may also include one or more directors, including the chairman of the board, the lead independent director or the chair of a relevant board committee. I believe portfolio managers and/or members of a shareholder's governance team (depending on the size and structure of the shareholder) typically represent the shareholder at those conversations.

Q.1.c. Do those communications sometimes lead to policy or other changes at corporations?

A.1.c. Yes. Various companies have amended their governance rules and documents, acted on recommendations about new director nominations, revised their executive compensation programs and enhanced their public disclosures, among other changes, as a result of such communications.

Q.2. There are two main proxy advisory firms. What are the barriers to entry in this space that prevent more competition?

A.2. Many institutional investors and pension funds have such large portfolios that smaller proxy advisory firms—whose coverage is more limited than that of the two main proxy advisory firms—simply are not able to provide the scope and breadth of coverage and services to those investors that the two main proxy advisory firms can. In other words, costs and limited resources prevent many smaller proxy advisory firms from being able to enter the market and scale their business offerings sufficiently to attract business from institutional investors.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNER FROM MICHAEL GARLAND

Q.1.a. Can you describe what informal communication occurs between shareholders or a particular shareholder and the board or management?

A.1.a. There is a certain degree of formality involved in most substantive communications between shareholders and a company, regardless of whether the dialogue is initiated by the company or its shareholders.

Shareholders generally initiate discussions by sending a letter or submitting a shareholder proposal.

Separate from these more formal meetings and discussions, there is very little informal communication. Informal communication often occurs at investor conferences (some larger companies with the capacity make an effort to participate in events) and via phone or email, and may relate to a particular shareholder question on something in the company's proxy statement.

Q.1.b. What topics are frequently discussed, and who is involved in those conversations?

A.1.b. Company-initiated discussions often occur in advance of the company's annual meeting and revolve around the various proposals subject to a shareholder vote at the annual meeting. Many companies will initiate discussions with shareholders following a negative voting recommendation from the proxy advisors, often on management's say-on-pay proposal. Some companies may also convene off-season discussions to hear shareholder feedback on the company's disclosures, corporate governance practices and policies and executive compensation.

Common topics of discussion include the company's corporate governance policies and practices, including the structure of the board and the independence of its leadership, as well as executive compensation.

Shareholders often initiate engagements to gain a better understanding of how the company is addressing a particular risk, and whether and how the board is involved, or to advocate for a particular corporate governance policy or practice, or for enhanced disclosure.

Typical management participants include the Corporate Secretary, Investor Relations and representatives with subject matter expertise relevant to the shareholder's request or concern, which could include someone from human resources to discuss employment practices or executive compensation, or someone involved in the company's sustainability program to review environmental or supply chain risks and responses. It is often helpful to have the participation of the Corporate Secretary given their knowledge of, and access to, the Board of Directors, whose approval of the request policy may be required.

Corporate directors sometimes participate in discussions, often in response to a specific request from shareholders, and their participation is valued by investors. Directors can provide shareholders with a window into how the board thinks about and oversees a particular risk or practice, and shareholders welcome the opportunity to make their case for particular reforms directly to the directors, whose support and approval is required, including for new shareholder rights or company disclosures, that might be opposed by management. Some topics are most appropriately discussed with independent directors, rather than executives who may be accountable to the CEO; these topics include the CEO's compensation and the leadership of the board in instances where the CEO also serves as board chairman.

Q.1.c. Do those communications sometimes lead to policy or other changes at corporations?

A.1.c. Yes. While some shareholders may engage mainly for informational purposes, the engagements initiated by the New York City Comptroller and pension funds are most often to advocate for a particular policy or practice, often successfully. During 2018, companies responded to our engagements by amending their bylaws to give shareholders the right to nominate directors using the company's proxy statement ("proxy access"), strengthening their executive compensation clawback policies, and disclosing data on the race and gender of their workforce, and whether they have a gender pay gap. Most of these successful engagements were initiated with a shareholder proposal. In our experience, shareholder proposals are far more likely to result in policy changes than engagements initiated in other ways.

Q.2. There are two main proxy advisory firms. What are the barriers to entry in this space that prevent more competition?

A.2. I believe the primary barriers to entry are the required economies of scale due mainly to the global nature of the portfolios of large institutional investors, such as leading asset owners like the New York City Pension Funds and leading asset managers, who are the primary clients of the proxy advisors. Given the paucity of competitors and new entrants, I suspect that proxy advisory services are a low margin business.

As I stated in my written testimony, the New York City Pension Funds use both of the main proxy advisors, ISS and Glass Lewis. Our decision to add a redundant advisory service followed (1) the enactment of the Dodd-Frank Act of 2010, which mandated advisory vote on executive compensation at U.S. companies, and (2) certain concurrent changes to our proxy voting guidelines governing how we vote on individual director candidates. Given the complexity of executive compensation and the importance we attach to director elections, it is valuable to have multiple research sources to enable us to apply our proxy voting guidelines on executive compensation and director elections.

While we would welcome the addition of qualified new vendors to the market, such vendors would need to meet our needs including providing sufficient coverage for our global portfolio. For the year ending June 30, 2018, our office cast 71,000 individual ballots at 7,000 shareowner meetings in 84 markets around the world, each market with its own language, governance norms and matters subject to shareowner voting. It is therefore essential that our proxy advisors have local market expertise. While smaller, market-specific vendors could team up, either through partnerships or more formally through mergers and acquisitions, to meet investors' global voting needs, this can create particular challenges for investors like us, who value receiving research reports in a standardized format that enables our voting staff to quickly and easily locate the information and metrics we need to apply our voting guidelines.

I believe the inability to provide global coverage was among the leading obstacles to the growth and success of Proxy Governance, a new proxy advisory service established in 2004 with the explicit support of the then-chairman of the Business Roundtable, which was then and now among the leading critics of ISS and Glass Lewis. In a 2004 memo to BRT members, then-chairman Henry McKinnell reportedly called on BRT members to help Proxy Governance "thrive in the marketplace" by using its services. Significantly, the BRT was reportedly Proxy Governance's first subscriber, buying about 160 subscriptions to its service for its members (see Morgenson, Gretchen, "Pfizer and the Proxy Adviser," New York Times, April 21, 2006, a copy of which is enclosed).

According to the enclosed New York Times column, Proxy Governance described itself "as a new breed of advisory service, providing advice that is "completely free of conflict and "with the goal of truly building long-term shareholder value, a formulation that appears to speak to the BRT's long-standing critique of ISS and Glass Lewis.

In addition to its inability to provide clients with a consistent global product, I understand that Proxy Governance's initial practice of sharing advance copies of its research reports to issuers was a source of concern to potential investor clients, who were apparently concerned about potential conflicts of interest or delayed receipt of research.

In light of the continuing attacks on the proxy advisors by the U.S. Chamber of Commerce and the BRT, encourage the Committee to examine the history and experience of Proxy Governance. I have attached an April 2006 column, entitled "Pfizer and the Proxy Adviser," by Gretchen Morgenson of the New York Times, that describes Proxy Governance's history and perceived conflicts of interest, which I would like included for the record with my testimony and written responses to the Committee's follow-up questions.

The New York Times

ARCHIVES | 2006

Pfizer and the Proxy Adviser

By GRETCHEN MORGENSON APRIL 21, 2006

Correction Appended

Directors of Pfizer Inc., up for election at the company's annual meeting next Thursday and under fire from shareholders over the pay awarded to executives, got a welcome show of support late last week from one of the nation's three proxy advisory services.

Proxy Governance Inc. of Vienna, Va., urged its investor customers to vote for all 13 of the drug maker's directors. In contrast, the other two advisory firms -- Institutional Shareholder Services of Rockville, Md., and Glass Lewis & Company of San Francisco -- have recommended that Pfizer shareholders withhold their votes from some board members because of the company's pay practices.

Differences of opinion, of course, make the financial markets go round. And the Proxy Governance report on Pfizer outlines in detail how it arrived at its opinion. It said the company should be given credit for making significant changes to its pay practices.

Nevertheless, a memo written in 2004 by Hank McKinnell, the chief executive of Pfizer, urging corporations to buy and promote Proxy Governance's services just as the firm was opening for business, raises questions about whether the advisory firm's Pfizer recommendation reflects an unbiased point of view or a relationship with the company and its top executive.

Recommendations made by proxy advisory firms carry significant weight and are closely watched each proxy season, when shareholders assemble to vote on matters relating to their company's management. Financial institutions can own stakes in hundreds of companies for their investor clients and rely heavily on these firms for advice on how to vote their shares in director elections and on other matters that come up at the meetings.

Naturally, the opinions issued by the three major proxy advisers are a matter of interest to Pfizer's board, its management and owners. But this is especially so now because the coming election at Pfizer will be subject to guidelines adopted by the company last year that require any director who receives less than 50 percent of the shares cast at the annual meeting to offer to resign from the board.

The 2004 memo supporting Proxy Governance was written by Mr. McKinnell in his capacity as chairman of the Business Roundtable, a Washington-based lobbying group for corporate America. Through a spokesman, he declined to comment on it. The memo was supplied by a recipient who was concerned about its tenor; he was granted anonymity because he feared retribution from Pfizer.

In it, Mr. McKinnell called on Roundtable members to help Proxy Governance "thrive in the marketplace" by using its services. "We have all seen the increasingly hostile recommendations from existing proxy advisory firms," he wrote, "who continue to promote narrow interests at the expense of long-term shareholder value." Identifying a "pressing need for a serious alternative," Mr. McKinnell continued, "we are pleased to report on the creation of Proxy Governance Inc."

Founded in 2004, Proxy Governance describes itself as a new breed of advisory service, providing advice that is "completely free of conflict" and "with the goal of truly building long-term shareholder value." Its founder, Steven M. H. Wallman, was a commissioner at the Securities and Exchange Commission from 1994 to 1997; the firm is a unit of Foliofn, a financial services company.

John J. Castellani, president of the Business Roundtable, said Mr. Wallman approached the organization in the early 1990's about starting a new proxy advisory firm. When he came back to them in 2004, they liked what they saw. "It met our criteria of independent, conflict-free and increasing the competition in investment advisory services," he said.

Mr. Wallman said that Mr. McKinnell's memo asking for support had no bearing on Proxy Governance's current or past opinions on Pfizer. The firm's analysts "do whatever they thought was the right thing and I have given them complete free rein to do that," Mr. Wallman said. "We don't have any conflicts; we don't provide consulting services; we don't provide services to short sellers; we don't do anything other than present our views or opinions."

Proxy Governance covers 3,000 United States companies. "Instead of subscribing to a best-practices principle that should be applied to all companies, we look at individual firms and how they performed in making a voting recommendation," said Shirley Westcott, managing director for policy at the firm.

In its Pfizer report, Proxy Governance concluded that the company's directors merited support from shareholders even though the pay awarded to Mr. McKinnell in recent years, including his pension benefit, exceeded that of the company's peers while its performance lagged theirs. Mr. McKinnell will receive $6.5 million a year after he retires.

"The amount of pay per se is really not that far above that of peer companies," Ms. Westcott said. "The issue, of course, is his pension payments. What we did here is we gave the company credit for the initiatives it has taken."

Those initiatives included removing the stock component of Pfizer executives' pay to calculate the company's pension payouts, and Pfizer's move to ask shareholders to approve future yearly pension payouts that exceed 100 percent of an executive's annual salary and bonus. "They also did a very good job of disclosing their pension benefits," Ms. Westcott said, "something very few companies did to date."

Neither of these actions persuaded either Institutional Shareholder Services or Glass Lewis to recommend shareholder support for Pfizer's entire board. I.S.S. advised owners to withhold votes from two directors: Dana G. Mead, chairman of the Massachusetts Institute of Technology Corporation, the university's board of trustees, and head of Pfizer's compensation committee; and George Lorch, a former chief executive of Armstrong Holdings, a maker of flooring and ceiling materials, who is also on the committee.

Glass Lewis recommended that Pfizer shareholders withhold support for M. Anthony Burns, former chief executive of Ryder System Inc., a transportation company, because he headed Pfizer's compensation committee from 1995 to 2005. During those years, the committee was slow to address and identify the growing pension benefit that was accruing to Mr. McKinnell and other executives, Glass Lewis said.

There are several relationships between Pfizer, the Business Roundtable and Proxy Governance. For example, William C. Steere Jr., Pfizer's chairman emeritus and one of its directors, is a member of Proxy Governance's policy council. The firm said that he did not participate in any matters involving Pfizer.

In addition, the Business Roundtable, headed by Mr. McKinnell, was Proxy Governance's first subscriber, buying about 160 subscriptions to its service for its members. Subscriptions ranged in cost from a few hundred dollars a quarter to $35,000 a quarter, the firm said. Mr. Wallman declined to say how much the Roundtable paid but said the bulk subscriptions stopped last year.

And, according to a public S.E.C. memorandum, James P. Melican, Proxy Governance's chairman until recently, represented the Business Roundtable at a private meeting with Cynthia A. Glassman, an S.E.C. commissioner, in October 2003, as the firm was being created. The Roundtable representatives attended the meeting to argue against an S.E.C. proposal that would have provided greater access to shareholders in the nomination of directors; the proposal subsequently died.

Margaret M. Foran, Pfizer's corporate secretary and its vice president for corporate governance, joined Mr. Melican as a Roundtable representative at the meeting. Mr. Melican could not be reached for comment.

One enthusiastic recipient of Mr. McKinnell's memo about Proxy Governance was Philip J. Purcell, then the chief executive of Morgan Stanley who was ousted from the firm last year. "We should put your heads together to see how we can support and use this service" he wrote in the memo's margin to three of his top lieutenants.

Even with help from the Business Roundtable, Proxy Governance's parent company, Foliofn, appears to be struggling. In January, a venture capital firm that had invested $15 million in Foliofn reported that it had written its value down to zero.

Correction: April 22, 2006, Saturday An article in Business Day yesterday about Proxy Governance Inc., which advises institutional shareholders on how to vote in board elections and other corporate matters, referred imprecisely to an investment in its parent company, Foliofn, by a venture capital firm. Although that firm did report in January 2006 that it had written down the investment to zero, that first occurred in September 2003.

A version of this article appears in print on April 21, 2006, on Page C00001 of the National edition with the headline: Pfizer and the Proxy Adviser; Drug Maker Has Ties to Firm That Endorsed Its Slate of Directors.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNER FROM THOMAS QUAADMAN

This hearing is about the proxy process, which is a key way shareholders communicate their views on important issues to boards and companies. But it is not the only way that shareholders engage in a dialogue with boards and management.

Q.1.a. Can you describe what informal communication occurs between shareholders or a particular shareholder and the board or management?

A.1.a. The Chamber has long supported effective and ongoing communication between shareholders, boards, and management. Over the last 15 years, we have observed a marked increase in both the level and quality of communication that occurs between these groups. According to the Chamber's most recent annual proxy survey, nearly 80 percent of companies report that they have some type of year-round regular communication program with institutional investors. Effective and transparent corporate governance systems that encourage shareholder communication and participation are critical for public companies to grow and compete.

While some communications are more formal, like a letter from a large asset manager to a company CEO, other communications are more informal such as phone conversations or meetings between investors and company executives or board members. In the past, many institutional investors may have only sought to engage on specific proxy issues that were up for a vote in a given year. Today, however, investors are engaging companies on a regular basis about the long-term strategy and risk management companies employ to ensure long-term profitability. Investors often communicate directly with the company, either through their investor relations department or directly with the board or management. Oftentimes, institutional investors have a team in their investment stewardship or governance team that handles engaging directly with companies on these issues.

In recent years, many large institutional investors have also started publicly announcing the largest topics they focus on from a corporate governance standpoint, and will conduct their conversations accordingly with companies. Because of this, issuers are more aware than ever about the types of baseline standards and practices investors are looking for, and therefore are better prepared to meet the expectations of their shareholder base.

Q.1.b. What topics are frequently discussed, and who is involved in those conversations?

A.1.b. The Chamber hears consistently from company directors and management that one of the top issues businesses face today is the effect of technological disruption on long-term performance. The rise of machine learning, artificial intelligence, and the growing "FinTech" industry all present challenges to established industries and companies, which must remain nimble and competitive in an ever-changing environment. Many institutional investors also engage on a number of traditional corporate governance issues, such as board composition, executive compensation, and management performance. There is also an increase in investor interest and engagement on environmental and social issues. As a result and to be responsive to this interest, over 80 percent of S&P 500 companies now publish an annual sustainability report that includes discussion of how companies handle environmental, social, and governance (ESG) issues.

While shareholder engagement doesn't always lead to an environmental or social proposal on the proxy statement, according to the Manhattan Institute's Proxy Monitor report, 56 percent of shareholder proposals at Fortune 250 companies during the 2017 proxy season dealt with social or policy concerns. While the vast majority of these proposals have failed to garner majority support of investors, they have shown up on company ballots with increasing frequency over the last decade.

Q.1.c. Do those communications sometimes lead to policy or other changes at corporations?

A.1.c. In many instances, these communications can lead to policy or other changes at corporations without having to be settled through the proxy process. Many board members and executives use shareholder engagement throughout the year to learn where their shareholders stand on the strategic direction of the company overall as well as key policy considerations before getting to the annual meeting. This allows management to gauge how patient and supportive their shareholder base is as they implement long-term strategies at the company designed to generate growth. Additionally, many asset managers use shareholder engagement as a tool to seek policy changes at a company, with a vote on a shareholder proposal or director election used as a last resort. However, with some estimates that proxy advisory firms can "control" up to 38 percent of the shareholder vote, shareholder engagement often can only go so far in working toward a constructive conclusion on a policy matter in some cases.

Proactive steps taken by issuers can also result in better communication and engagement between companies and issuers. For example, the Edison Electric Institute (EEI) recently launched an initiative that develops baseline standards for sustainability reporting in the electric utility industry. This project was the result of collaboration between both companies and investors and has been positively received by many market participants. EEI reported that as a result of the initiative and increased communication, 17 shareholder proposals at its member companies were withdrawn during the 2018 proxy season.[1] Since shareholder proposals are often submitted only after a breakdown in communication between shareholders and businesses, this should be viewed as a positive development and way forward for other companies to manage expectations related to ESG reporting.

Q.2. There are two main proxy advisory firms. What are the barriers to entry in this space that prevent more competition?

A.2. As has been mentioned, two firms—Institutional Shareholder Services (ISS) and Glass Lewis—constitute roughly 97 percent of the proxy advisory firm market. Both companies have significant conflicts of interest. ISS for instance operates a subsidiary that

[1] *http://www.eei.org/issuesandpolicy/finance/Documents/EEI%20ESG%20White%20Paper__Nov2018.pdf.*

provides consulting services to businesses seeking favorable vote recommendations on shareholder proposals, and Glass Lewis is owned by an activist investor pension fund. Additionally, the economic interests of proxy advisory firms are not always aligned to ensure the best interests of the companies they are rating. Given proxy advisory firms' for-profit business model, this creates less incentives for them to make accurate recommendations or to provide accountability throughout the rating process. This limits competition among proxy advisory firms by pushing them to make "one-size-fits-all" voting recommendations and limiting the amount of due diligence they can perform, thereby creating an ultimately inferior product.

Additionally, the sheer volume of vote recommendations performed currently by proxy advisory firms represents a significant barrier to entry. According to ISS, the firm covers more than 20,000 companies around the globe and executes 9.6 million ballots representing over 3.7 trillion shares. Additionally, as of June 2017, the ISS Global Research team covered 40,000 shareholder meetings with approximately 270 research analysts and 190 data analysts. Glass Lewis purports to analyze fewer issues but as fewer analysts to do so (approximately 200 in 2014) ensuring that its analysts are equally overwhelmed with their responsibilities in a short period of time.

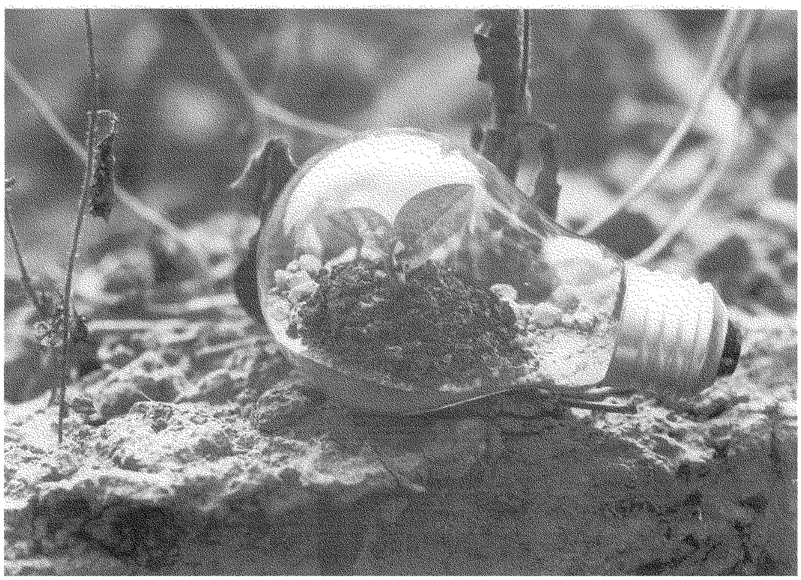
Attempts have been made to enter the market. In the late 2000s PGI and a few years ago Proxy Mosaic attempted with varying levels of success. However, neither was successful over a long period of time. The barriers to entry appear to be somewhat similar to the Credit Ratings Agencies.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

IRRC Institute

SI Sustainable Investments Institute

State of Sustainability and Integrated Reporting 2018



For more information, please contact:

Jon Lukomnik, Executive Director
Investor Responsibility Research Institute (IRRCI)
One Exchange Plaza, 55 Broadway, 11th Floor
New York, NY 10006 (212) 344-2424
info@irrcinstitute.org
www.irrcinstitute.org

Sol Kwon, Senior Consultant
Sustainable Investments Institute (Si2)
sol@siinstitute.org

Heidi Welsh, Founder & Executive Director
Sustainable Investments Institute (Si2)
(301) 432-4721
heidi@siinstitute.org
www.siinstitute.org

The IRRC Institute will dissolve by December 31, 2018. Its intellectual property will be assumed by the Weinberg Center at the University of Delaware.

As of January 2019, please refer to www.weinberg.udel.edu.

The Sustainable Investments Institute (Si2) is a non-profit organization which helps its institutional investor subscribers make informed, independent voting decisions on social and environmental shareholder proposals. Si2 also researches related efforts to influence corporate policies, explaining what investor reformers want and how companies respond. Primary support comes from annual fees paid by the largest U.S. college and university endowments and the largest North American pension funds.

This report was written by Sol Kwon. Data collection was by Sol Kwon, Heidi Welsh and Robin Young, Si2's Research Director. The report was edited by Heidi Welsh.

Table of Contents

Executive Summary

Sustainability reporting for large public companies around the world has become the norm. Si2's research this year (2018) found that 78 percent of the S&P 500 issued a sustainability report for the most recent reporting period, most with environmental and social performance metrics. The rate of sustainability reporting for the world's largest companies is even higher, with some figures noting as high as 93 percent.[1] This is a starkly different picture from the 1980s, when a handful of companies in vulnerable sectors—extractives and chemicals, which had to respond to public backlash against environmental mishaps—were the only ones to publish environmental reports with limited performance metrics. It was not until the 1990s that sustainability reports as we know them today started gaining traction, after the concept of "triple bottom line"—environmental, social and economic—corporate performance was introduced and became popular.

> *Integrated reporting reflects a critical point in the evolution of financial accounting practice. Its core purpose is to ensure that organizations provide a more accurate account of their creation or destruction of value among the different forms of capital. It achieves this by shifting the focus away from the traditional exclusivity of financial measurement.*
>
> — Dr. Robert Massie (Co-founder), GRI

Now, almost three decades later, the landscape is again ripe for a shift. This time, the new concept is "value creation," that companies should create shared value for all—including investors, employees, suppliers, communities and the environment. Proponents say that companies should disclose how they integrate the triple bottom line impacts through a more holistic report of its inputs and outputs, through what's called an integrated report. Integrated reports would elevate the status of material sustainability matters to be commensurate with financial ones, and help investors make more informed decisions.

Si2, with funding from the IRRC Institute, last looked at these issues in 2013 in a first-of-its-kind analysis of the state of integrated reporting among the S&P 500, *Integrated Financial Sustainability Reporting in the United States.* But the world has seen a number of important changes in the five years since then. In the background are a number of historic developments including the spread of the Internet, the coming of age of the Internet generation, dwindling public trust in institutions and a scientific consensus about the threat of global climate change. All these factors have increased expectations from a wide range of corporate stakeholders—consumers, investors and regulators—about the role businesses should play in society and how they should make positive contributions.

At the same time, investors in the United States and around the world continue to integrate environmental, social and corporate governance factors into their analyses. The Principles for Responsible Investment, which call for such integration, are now supported by large institutional investors with a total of $82 trillion in assets under management.[2] By comparison, the entire Gross National Product (GNP) of the United States is about one-quarter of that amount. Investors are clearly fueling demand for more and standardized corporate environmental and social data. With investor attention on such information higher than ever, corporate sustainability reporting is ripe for the next phase of its evolution. In addition, introductions of new integrated reporting frameworks from the

[1] See *The Road Ahead: KPMG Survey of Corporate Responsibility Reporting 2017.* https://home.kpmg.com/content/dam/kpmg/campaigns/csr/pdf/CSR_Reporting_2017.pdf
[2] As of April 2018. See https://www.unpri.org/pri/about-the-pri

International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) have raised expectations for companies in ways that may not only change how companies report on sustainability, but also how they define their corporate identities and approach business in general.

It is with this background that Si2 launched this year's update of the 2013 review, using a new lens. This year's research takes a higher level view of the S&P 500's sustainability and integrated reporting than the earlier, more granular study. The 2013 report focused on what was being reported by the companies in their financial filings without regard to their status as mandatory versus voluntary measures. This year's research focuses only on voluntary disclosures. This year's research also concentrates on which sustainability reporting frameworks companies reference, to gauge the spread and influence of integrated reporting frameworks, as well as to uncover where corporate reporting is headed.

Broadly, Si2's 2018 analysis looks at:

1) how many U.S. S&P 500 companies now are *reporting on sustainability performance and strategy*
2) how many are issuing *stand-alone integrated reports*[3] and
3) how many are including *voluntary sustainability information in financial reports.*

Knowing the tally of reports is essential for assessing the voluntary inclusion of sustainability information in financial reporting. This year's review therefore set out to capture the influence of many important new developments driving the convergence of corporate financial and sustainability reporting.

Key Findings

Si2's key findings paint a dynamic picture of corporate sustainability reporting. Most companies reporting on sustainability issues are navigating the landscape in their own way, using multiple reporting models and customizing guidance for their own needs. The number of integrated reporters in the S&P 500 has doubled since 2013, although from a low baseline (14 now issue such reports, up from seven five years ago). But Si2 also found a surprising share of companies are including sustainability information in their financial filings—annual reports, Forms 10-K and proxy statements—indicating elementary but growing acceptance that sustainability information is material to investors. All these findings show most companies are paying attention and adapting to raised expectations from stakeholders, including but not limited to investors. Integrated reporting just may be the future of corporate disclosure its proponents assert, even if change is slow and constantly shifting.

More specifically, Si2 reached the following key findings from this year's assessment of sustainability reporting among the S&P 500:

- **A total of 395 companies (78 percent) issue sustainability reports, in either a discrete, downloadable format (68 percent) or only on the web with unclear boundaries (9 percent).**

[3] Si2 counted as integrated reports those that were self-declared as such, with one exception. **Allstate** did not make a declaration but had all of the comparable qualities—mainly, combining financial and sustainability information within its annual report—and was counted as an integrated report.

- Most of these reports (95 percent) offer *environmental performance metrics* (quantified measures that are comparable year-over-year), while 67 percent set quantified and time-bound *environmental goals*.
- About 86 percent offer *social performance metrics*, although Si2 cast a wide net and gave full credit for the most common social metrics including injury and accident rates. *Goal setting for social performance* was much lower than for the environment, however, in place for just 40 percent of all reporting companies.

- **Most lack external assurance; only 36 percent of sustainability reports include it.**
  - About 90 percent of external assurance pertains only to some data, in most cases greenhouse gas (GHG) emissions.
  - Only 3 percent of reporters stated their reports' environmental *and* social performance data were externally verified, although significant ambiguity exists given the varying language companies use and the level of transparency they offer about external assurance.
- **Nearly all (97 percent) of reporting companies chose to customize extant sustainability reporting models—in style, format and content—instead of closely following any one framework.**
  - Only 10 reporting companies issue sustainability reports that follow only one reporting framework *closely*, using either the GRI or an industry-specific model.
  - 106 companies (27 percent) reference and *loosely* follow just one framework, while 46 percent reference *two or more* reporting models.
  - 97 companies (25 percent) *do not reference* any reporting models.
- **A minority of the S&P 500 references a recognized integrated reporting framework.** SASB is cited as an influence by 35 companies (9 percent), while four companies reference the IIRC.
- **Fourteen S&P 500 companies issued an integrated report in 2018, twice the number in 2013.**
  - Neither the size of a company (in revenue) nor its share of income from international markets seems to influence the likelihood a company will use integrated reporting.
  - About half the integrated reporters obtained some form of external assurance for their sustainability data, a much higher rate than reporters as a whole.
- **Integrated reporters are more likely to treat sustainability information as material to investment decisions,** making it easier for them to include it in normal business review processes.
  - All 14 companies offered their integrated reports under the investor relations section of their websites.
  - Seven companies used their integrated reports as their annual reports, although only two—**Intel** and **Clorox**—included voluntary discussion of sustainability in their 10-K business descriptions.
- **Many more integrated reporters (71 percent) have a board committee overseeing sustainability issues than do general reporters (42 percent).**

- **Integrated reporters noted varying degrees of influence from sustainability reporting models.**
    - References to integrated reporting frameworks were low even in among those doing it, with just four citing SASB and three citing IIRC. Two companies—**Pfizer** and **Praxair**—referenced both SASB and IIRC.
- **IIRC's influence may be greater than it seems, however. Eleven (79 percent) of the integrated reports address the concept of "creating shared value for all," the central tenet of IIRC.** This departs significantly from traditional business theory—that the sole purpose of business is profit—and addresses the increasing expectations of investors and other stakeholders about corporate ESG (Environmental/Social/Governance) data disclosure.

"To continue creating prosperity businesses must take on a bigger role in society. Let's be clear, a business needs to make an acceptable profit since this is a measure of how effectively it uses society's resources. Yet more is expected and needed from business. Eighty-seven percent of young Americans believe that businesses need to do more than make a profit. Companies also need to be held accountable for creating jobs, making sure free markets work and improving our communities."

— **Allstate** (Chairman's Letter, *2017 Prosperity Report*)

- **A surprising share of the S&P 500 includes voluntary sustainability information in financial reports, but the extent varies widely.**
    - Companies representing about 40 percent of the S&P 500 now include the concept of sustainability in *annual reports* or *Forms 10-K*.
    - A total of 191 companies (38 percent) include discussions of corporate responsibility or sustainability in their *proxy statements*, beyond the traditional discussion of board governance and executive compensation.
    - A total of 212 companies (42 percent) have a formal *board committee* overseeing sustainability. (As noted above, 71 percent of integrated reporting companies do.)

In This Report

This report is organized into two broad sections:

I. **Background:** This section describes why Si2 believed it was important to revisit the analysis of integrated reporting among the S&P 500 at this time. It sets out important changes—in the world at large and in the financial markets—that have taken place in the past five years, which may have profound implications for the future of corporate sustainability reporting. . It also explains key differences between Si2's study in 2013 and this one.

II. **2018 Findings:** This section presents the results from Si2's 2018 review of the S&P 500's sustainability reporting practices in two parts:

- **State of Sustainability Reporting 2018:** This section shows how sustainability reporting has become the normal practice among U.S. companies, but notes the quality of these reports varies widely. As key indicators of report quality, Si2 looked at whether the reports offer *environmental and social (ES) metrics*, if *information is verified* by a third-party and if a *materiality analysis* and *stakeholder engagement process* are disclosed—

as broad but illustrative indicators.[4] In addition, Si2 looked at which sustainability reporting *guidelines* are being used by the companies, including those offered by the IIRC and SASB, as an indicator of where reports may be headed.

- **State of Integrated Reporting 2018:** This section focuses on the disclosure practices of the small group of companies that have issued integrated reports, identifying patterns and key takeaways. Si2 finds that the number of integrated reporters has grown slowly in the last five years, but those that do report seem to be listening to the latest thinking about the reimagined role of companies in society, using a lens of value creation. Si2 also looked at the S&P 500's financial filings—Forms 10-K and proxy statements—and reviewed how many include voluntary sustainability information beyond compliance requirements.[5] Si2 finds that a surprising share of companies already have expanded their ESG reporting in financial filings, albeit mostly at a rudimentary level.

Study approach: Following the sample group from its 2013 research, Si2 examined the S&P 500 as of May 2018—a total of 506 companies—and their 2017 annual revenue figures. When Si2 accessed the list of S&P 500 in the beginning of 2018 it included a total of 505 companies; we further separated out Dow and Dupont—which is listed as one entity but still had separate sustainability reporting practices—bringing the total number to 506. The study uses a new set of indicators to review:

1) how many among the U.S. S&P 500 companies are now *reporting on sustainability performance* and strategy,
2) how many are issuing *stand-alone integrated reports* and
3) how many are including *voluntary sustainability information* in their financial reports.

Information came from company websites examined between June and August. *(See Appendix, part 1, p. 38, for the full list of indicators.)*

[4] While Si2 recognizes the importance of accounting for "triple-bottom line" sustainability— including the environmental, economic and social—it focuses on environmental and social indicators for this study.

[5] This meant that the company intentionally addressed the issue in a way that provided at least minimal insight into the company's approach to sustainability. Mere mentions of sustainability awards were not given credit; acknowledgements of sustainability efforts in a board chair's letter in the annual report or stand-alone sections on sustainability management in 10-Ks or proxies were given full credit.

I. Background

Study in 2013

The Sustainable Investments Institute (Si2), with sponsorship of the Investor Responsibility Research Center Institute (IRRCi), published in 2013 a first-of-its-kind analysis of the state of integrated reporting among the S&P 500. *Integrated Financial Sustainability Reporting in the United States* looked at how many companies were including environmental and social information in their financial filings and/or issuing stand-alone integrated reports, detailing many historical and regulatory forces driving the push for corporate sustainability disclosure.

While it found the majority of U.S. companies disclosed a number of environmental and social information in their Securities and Exchange Commission (SEC) filings, much reporting was driven by regulation. For example, 66 percent of companies studied included a discussion on climate change in their Form 10-Ks. Only a handful—seven—had issued full and voluntary integrated reports that sought to present a more holistic picture of the companies' operations.

Integrated reporting, *as defined by its present champions, seeks to identify value drivers in companies linked to human, intellectual, natural and social capital, in addition to more traditional financial and manufactured forms of capital, and to present this information to investors in regulatory filings, such as Form 10-Ks or glossy annual reports.*

—*Integrated Financial and Sustainability Reporting in the United States*, 2013

The definition of integrated reporting remains as elusive today as it was in 2013. Si2's last report focused in part on a model of sustainability disclosure through regulatory filings, as was the dominant thinking at the time *(see box above)*. But since then, a newer framework espoused by the International Integrated Reporting Council (IIRC) has presented a more flexible approach focused on principle and efficiency, rather than location of information, giving companies more choice. This model has been embraced in many international markets and become the standard in some.

Still, many other proponents of integrated reporting stand by the importance of disclosure through regulatory filings. Squarely in this camp is the newest reporting framework, the U.S.-based Sustainability Standards Accounting Board (SASB); it issued Provisional Standards for public comment in October 2017 and issued a final iteration on November 7, 2018. SASB's framework presents much more detailed guidance on the *what, how* and *where* of corporate sustainability reporting. It presents a model in which a prescribed set of material sustainability metrics is disclosed in the companies' Forms 10-K or 20-F filings with the SEC, primarily for the benefit of investors. SASB supporters also are exploring taking the approach to global markets, and have worked to ensure the approach is aligned with other major global initiatives. *(See box above; details about the IIRC and SASB frameworks are on pp. 19-24.)*

"SASB's mission is to develop and disseminate industry-specific sustainability accounting standards to assist public corporations in disclosing material, decision-useful information to investors in mandatory filings with the Securities and Exchange Commission ("SEC"), such as Forms 10-K and 20-F."

--SASB Rules of Procedure

Si2's 2013 report found integrated reporting in the United States at a crossroads. This remains true today. Yet important developments since then have changed and matured the landscape further, including the new frameworks noted above. Hence Si2 started out this year to take the current pulse of U.S. companies and their adoption of integrated reporting, with a new set of benchmarking indicators.

Current Study

Most importantly, while the 2013 report looked at required environmental and social information within the companies' regulatory filings, this year's report only counts voluntary disclosures outside of required regulatory disclosures. This change recognizes the extreme variance in the quality of compliance-based information. The current study also seeks to measure how many companies have gone past compliance. For example, a perfunctory and general statement about the threat of climate change under the "risk items" section of the Form 10-K, as required by law, may convey little information about a company's thinking on the matter, while voluntary and stand-alone disclosure on the same topic elsewhere in the document could tell much more, including whether a more detailed discussion is proffered at all. In addition, unlike Si2's 2013 review, this year's study takes a macro-perspective on the state of sustainability and integrated reporting. *(See the complete list of indicators in Appendix 1, p. 38).* It focuses less on the content of *what* is reported and more on *how* and *why* data are disclosed.

Broadly, Si2's 2018 analysis looks at:

1) how many U.S. S&P 500 companies are now reporting on sustainability performance and strategy,
2) how many are issuing stand-alone integrated reports *(box, right, explains what the study counts as a fully integrated report)* and
3) how many are including voluntary sustainability information in their financial reports.

Knowing the tally of reports is essential for assessing the voluntary inclusion of sustainability information in financial reporting. This study therefore set out to capture the influence of many important new developments driving the convergence of corporate financial and sustainability reporting.

Integrated Reports, 2018

Si2 counted as integrated reports those that were self-declared as such, with one exception. **Allstate** did not make a declaration but had all of the comparable qualities—mainly, combining financial and sustainability information within its annual report—and was counted as an integrated report.

Recent Developments in Corporate Sustainability Reporting

The world has seen a number of important changes since our last report. In the background are a number of historic developments including the spread of the Internet, the coming of age of the Internet generation, dwindling public trust in institutions and a scientific consensus about the threat of global climate change. All these factors have increased expectations from a wide range of corporate stakeholders—consumers, investors and regulators—about the role businesses should play in society and how they should make positive contributions.

At the same time, investors in the United States and around the would continue to integrate environmental, social and corporate governance factors into their analyses. The Principles for Responsible Investment, which call for such integration, are now supported by large institutional investors with a total of $82 trillion in assets under management.[6] By comparison, the entire GNP of the United States is about one-quarter of that amount. Investors clearly are fueling the demand for

[6] As of April 2018. See https://www.unpri.org/pri/about-the-pri

corporate environmental and social data. With investor attention on and trust in such information higher than ever before, corporate sustainability reporting is ripe for evolution. In addition, introductions of the already-mentioned integrated reporting frameworks such as those from IIRC and SASB have raised expectations for companies, in ways that may not only change how companies report on sustainability, but also how they define their corporate identities and approach business in general.

Changing World, Changing Expectations

The world online continues to converge with every new Internet user, every day. Although still short of majority, the share of population around the world using the Internet has grown consistently, reaching 46 percent by 2016. More than ever, access to all kinds of information is at the touch of a fingertip, delivered in seconds. Mobile access means that information is available 24/7. In this age of unfiltered information, public trust in institutions is fragile, although businesses have fared better than governments and the media.[7] Access to information also has empowered consumers. The majority in developed markets are now willing to make purchasing decisions based on facts other than price; people also expect more from companies as producers of goods, employers and even leaders of social change. For example, a February 2018 survey on trust found that 63 percent of the general public expressed willingness to stop buying from a company when trust is violated. It also found that 64 percent expected CEOs to be agents of change rather than followers of it; 56 percent believed that companies that focus only on profits are "bound to fail."

This certainly marks an expansion in stakeholder expectations of business, compared with just three decades ago when the term "sustainable development" set out by the United Nations espoused a new and particular concept: development without harm for future generations. Yet the expectations for business are seemingly even greater among the younger generations of Millennials and Generation Z[8], who overwhelmingly believe companies' missions should be beyond profit and include making a positive difference in the world. According to the latest survey of Millennials from around the world, 83 percent believed that business success should be measured by more than financial performance alone. More specifically, they believe that businesses should set out to achieve "a broad balance" of the following:

> *In the future, most Americans, taking their cue from Millennials, will demonstrate a greater desire to advance the welfare of the group and be less concerned with individual success. They will be less worried about being guided in their daily decisions by software and more intrigued by the opportunities it offers. Even without any major environmental disaster, they will display a greater reverence for the environment and less interest in the acquisition of things as opposed to experiences.*
>
> — *How Millennials Could Upend Wall Street and Corporate America*, Brookings Institute

- *Making a positive impact on society and the environment,*
- *Creating innovative ideas, products and services,*
- *Job creation, career development and improving people's lives* and
- *An emphasis on inclusion and diversity in the workplace.*[9]

---

[7] See *2018 Edelman Trust Barometer: The State of Trust in Business*, http://cms.edelman.com/sites/default/files/2018-02/2018_Edelman_Trust_Barometer_State_of_Business.pdf

[8] Millennials were born between January 1983 and December 1994, Generation Z members were born between January 1995 and the mid-2000s.

[9] 2018 Deloitte Millennial Survey, https://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html

Some experts therefore conclude that the world economy is due for a major shift, to one that focuses more on the collective good and well-being of people and the planet. *(Box, previous page.)*

Some of these dynamics are already playing out. Faced with rising temperatures—2017 was the third warmest year on record, after 2016 and 2015, respectively—and the threat of global climate change, the world has mobilized with renewed energy for a collective response. In September 2015, 193 countries signed on to the United Nations' 2030 Sustainable Development Goals (SDGs), a 17-point agenda designed to address the most pressing global development challenges. A few months later, countries negotiated the historic Paris Climate Accord, which seeks to fight climate change by keeping global temperature rise in this century below a 2-degree Celsius increase over pre-industrial levels.

Key corporate stakeholders expect the private sector to take an active role in these endeavors. Many companies have responded. For example, in the United States about 1,784 businesses have joined the We Are Still In coalition—a voluntary network of public and private institutions pledging to honor the country's commitments to the Paris Accord after the Trump administration backed out; they are making progress on their own to cut emissions and publicly report on this progress. For the 2030 SDGs, organizations such as Business for 2030 seek to mobilize business partnerships to advance the goals; it counts 218 initiatives from 54 companies and organizations to date.

On the regulatory front, the most recent push for corporate sustainability has come from Europe. The European Union Directive on non-financial and diversity reporting, passed in 2014, requires large public companies to include a sustainability statement in their annual reports from 2018 onward, although much of its implementation is left to member countries. Similarly, a number of countries including South Africa, the United Kingdom, Japan and India have already taken measures to require different forms of sustainability reporting for public companies, driving the rate of disclosure upward in those markets.

In addition, another softer push for requiring corporate sustainability disclosure has come from the United Nations' Sustainable Stock Exchanges (SSE) initiative. Launched in 2009, the SSE works with exchanges to guide their listed companies on ESG practices and reporting. It currently lists 76 such partnerships at various stages of commitment. In the United States, both Nasdaq and NYSE have signed on as partners. While neither has committed to require ESG reporting as a listing rule, Nasdaq has pledged to formalize its support for ESG reporting by committing to publish its own guidelines in the near future.[10]

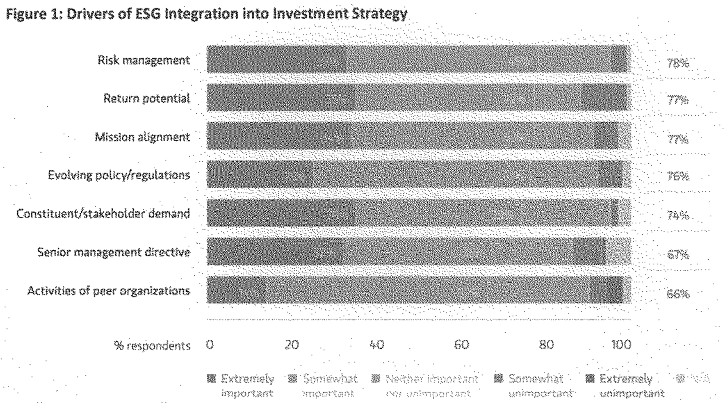
As the above developments illustrate, many forces have driven companies to pay more attention to their ESG practices and reporting. These changes have occurred alongside key developments in the investment community that are pushing for improved disclosure of sustainability issues deemed material to companies' long-term health.

[10] NASDAQ has already published an ESG reporting guideline, but only for companies listed on its Nordic and Baltic exchanges. See https://business.nasdaq.com/esg-guide/list-of-sustainability-resources.html. There is no specified timeline for if and when it will issue one for its US exchanges.

Growing Responsible Investment & Investor Awareness

The U.S. Social Investment Forum (US-SIF) notes that $8.7 trillion (almost 22 percent) of the $40.3 trillion in total assets under professional management in the United States in 2016 was managed by funds using socially responsible investment (SRI) strategies. This marks 33 percent growth from $6.6 trillion in 2014, and the share of responsibly invested funds had grown a whopping 14-fold since the group began tracking data in 1995. The trend is similar worldwide. Globally, responsible investing grew 25 percent between 2014 and 2016, according to Global Sustainable Investment Alliance (GSIA). Responsible investment around the world amounted to $22.9 trillion in 2016, GSIA says, representing about 26 percent of all professionally managed assets worldwide. Similarly, as of April 2018, the Principles for Responsible Investment (PRI), boasted a total of 1,961 signatories from 373 asset owners around the world, representing almost US$82 trillion in total assets under management. This is a huge jump from when the group started out in 2006, with only 63 signatories from 32 asset owners, representing about $6.3 trillion in total assets under management.

Figure 1: Drivers of ESG Integration into Investment Strategy



Source: *Sustainable Signals: Asset Owners Embrace Sustainability*, Morgan Stanley, June 2018

ESG integration in investment strategy by mainstream funds continues to accelerate. Most recently, a November 2017 survey of 118 large global investment institutions found that 84 percent of these asset owners were "pursuing or actively considering pursuing" ESG integration in their investment process. Of these, 60 percent had begun implementing ESG strategies in the last four years and 37 percent had in the last two years. About 70 percent had already implemented ESG strategies at the time of the survey, 49 percent across their entire portfolio and 21 percent within a portion of their portfolio.

Motivators for choosing ESG integration varied. While the survey found 77 percent of respondents agreed with the statement, "Asset owners have a responsibility to address global sustainability issues through their investments," it found the top reasons were to include risk management and return potential—as well as mission alignment and constituent/stakeholder demand. *(Figure 1, above.)*

Despite this enthusiasm, the survey found challenges to implementation remain. Topping the list of impediments was the "proof of market-rate financial performance" for sustainable investing, with 24 percent of respondents citing this challenge, followed by 23 percent reporting the lack of quality ESG/sustainability data.

Investor frustration with the quality of sustainability information is nothing new. While a 2016 investor survey from Ernst & Young found that the share of investors who used a company's sustainability performance as part of their investment process had grown from 52 percent to 68 percent in just one year, those who believed that companies needed to disclose more of such data also grew from 64 percent to 81 percent. That survey also found that the share of investors who believed that sustainability data were "often inconsistent, unavailable or not verified" had grown from 32 percent to 42 percent between 2015 and 2016; those who complained about the incomparability of this information had grown from just 16 percent to 42 percent in the same period. In addition, the majority of investors believed that companies disclosed sustainability information to build corporate reputation with customers (74 percent) or to comply with regulation (62 percent), rather than to satisfy investor need for information (38 percent), highlighting the divide between where corporate sustainability disclosure has been and where it needs to be to meet investor needs.

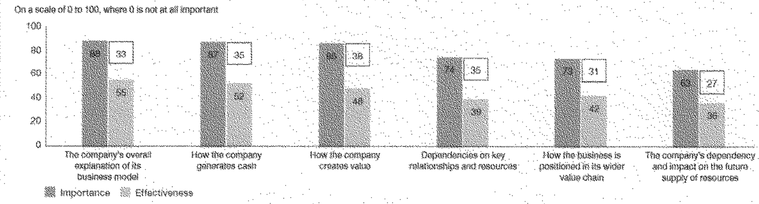
Integrated Reporting Benefits for Companies and Investors

Integrated reporting seeks to fill the information gap between a firm's risk and return potential by telling a more wholistic picture of its inputs and outputs, by linking resource allocation to business strategy in a rapidly changing and responsive environment. As illustrated above, today's investors need and want to take into consideration the environmental, social and economic factors that may influence a firm's short-, medium- and long-term performance, and how these factors are being incorporated into its strategy. A 2014 survey of investment professionals more clearly outlines these information gaps, with some surprising results. *(Figure 2, below.)*

Figure 2: Effectiveness Gaps for Investors in the Current System of Corporate Reporting

How important is each of these pieces of information provided by a company for your analysis, and how effective is the information that you currently receive in all aspects of company reporting?

On a scale of 0 to 100, where 0 is not at all important



Note: The analysis has been prepared using a Likert model. A score of 100 would be equivalent to every respondent giving a score of 5/5 for importance or effectiveness. The number in the box next to each column is the 'effectiveness gap'.

— *Corporate performance: What do investors want to know? Powerful stories through integrated reporting*, PwC, September 2014

Two Company Views

Si2 interviewed officials from two large companies that issue integrated reports about the reasons why they prepared these reports and the value they see in them—with contrasting results:

- Despite issuing an integrated report, an official from one of the companies expressed considerable skepticism about the report marking any significant change in ESG reporting or practice at her company. She indicated her firm did not include a materiality analysis in the report given wariness about what she sees as potential legal issues connected to risk disclosure, and said most significant ESG risks are not, in fact, financially material to her firm. She stressed the expense of creating the integrated report, and noted all the information in it is already gathered as a routine matter of business. Further, "I'm skeptical that [integrated] report itself drives increased transparency or changed behavior within the company because it's really a summary of prior, sometimes more detailed, disclosures." Still, she said the report is a useful resource for the board in answering questions about the company, bringing together high level information about both ESG and financial performance. It also serves management in its work on shareholder engagement, "which is ever increasing."
- Another integrated reporter was much more positive about the practice. A longtime discloser, she said sustainability reporting has undergone "huge" evolution in the last decade or so, and that her sector (which is more likely to report than others) contains more mature reporters that are "bringing others along" from other sectors. She said the drive for more transparency changes how a company thinks of itself and its business, and in doing so encourages "out of the box" thinking and more innovation. She agreed reporting may carry some legal risks, but believes this will change as reporting evolves further. While her firm's report is not externally assured, she noted it is audited internally, painstakingly, and she is confident its reported data are accurate. She sees the current landscape of frameworks as having room for clarification, with a struggling IIRC, an emergent but highly prescriptive SASB, and GRI moving to standards. Looking ahead, she foresees more customized reporting—with initiatives that may be issue- and industry-specific—which her experiences suggests investors like. Commenting on the public policy environment and the wide gap between the current deregulatory fervor in Congress and corporate moves that embrace the concept of sustainability, she concluded that "the train has left the station," and that companies are setting sustainability goals based on their customers' preferences and economic analysis that favors more action in this area, not less—whatever happens with regulation.

Integrated reporting seeks to minimize informational risk-return gaps so that investors can make better informed decisions about their investment needs. The central principle is value creation, that corporate disclosure should accurately reflect how well a company manages various types of assets' value—such as physical resources, reputation and stakeholder relationships—over time, recognizing that its ability to create value in the future is affected by its past and present activities. Advocates of integrated reporting say this can be communicated through their approach to disclosure, which should reflect how well sustainability issues have been integrated into a firm's business and management strategy. These advocates assert that sustainability reporting is a necessary step before integrated reporting, since the sustainability reporting process is a fundamental precursor to integration, and that the two types of reports should serve the different information needs of different audiences. Integrated reports target the needs of investors, while sustainability reports can serve the needs of the general public, civil society organizations and consumers.[11]

Initial research on current disclosure practices suggests that integrated reporting can benefit both companies and investors though it may still be too early to determine the real effectiveness of integrated reporting. For example, a 2014 survey of early adopters (according to the IIRC model) suggests benefits for all. In financial markets, companies reported the following:

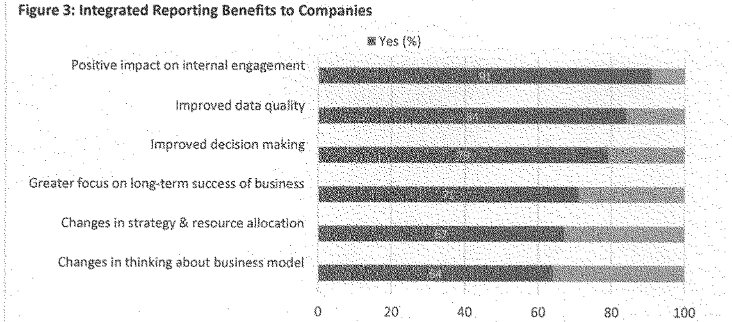
- Improved relationships with institutional investors (56 percent) and financial analysts (52 percent),
- Better understanding of the firm's strategy by investors (87 percent) and
- Greater confidence in the long-term viability of its business model by investors (79 percent).

Similarly, a 2016 survey of investors illustrated a clear preference for integrated reports over sustainability reports as a source for corporate information outside traditional financial assessment; about 57 percent considered integrated reports "very useful" to "essential" in making investment decisions, second only to annual reports (63 percent). Only 44 percent felt the same about corporate social responsibility or sustainability reports.

For companies, the 2014 survey of early adopters found improved internal engagement (91 percent) as the most significant benefit, followed by improved data quality (84 percent), better decision making (79 percent) and greater focus on long-term business success (71 percent). *(Figure 3, below.)*

In addition, findings from at least one independent researcher supports value for company-investor relations. According to "Integrated Reporting and Investor Clientele" in the *Journal of Applied Corporate*

Figure 3: Integrated Reporting Benefits to Companies



Source: *Realizing the Benefits: The Impact of Integrated Reporting*, IIRC, 2014

[11] See *Forging a Path to Integrated Reporting*, Global Reporting Initiative, 2016. https://www.globalreporting.org/information/news-and-press-center/Pages/Forging-a-path-to-integrated-reporting.aspx

Finance in spring 2015, companies that practice integrated reporting "have a more long-term oriented investor base with more dedicated and fewer transient investors."

A Sea of Sustainability Reporting Models

Despite what seem to be clear benefits, integrated reporting remains a foreign concept for most U.S. companies today, at least as reflected in their public disclosures. The rate of adoption for integrated reporting in the United States has been steady but slow, as this report shows. *(Details, pp. 34-35).* Despite the wide proliferation of corporate sustainability reporting, reports are at best inconsistent and at worst missing performance metrics entirely for some companies, with each report directly reflecting a different stage of a company's reporting maturity an sustainability experiences. Proponents of integrated reporting remain vigilant in their push, most notably through offering reporting guidelines.

One of the most effective approaches that has influenced corporate sustainability reporting has been the introduction of various guidelines and frameworks. One of the first and most effective is the Global Reporting Initiative (GRI), which set forth a detailed set of standards based on the "triple-bottom line" performance model in 1999 and is now in its fifth iteration. The GRI continues to be the most referenced framework for corporate sustainability reporting worldwide. A recent survey found 75 percent of the world's largest 250 companies use GRI; Si2 also found that 60 percent of the S&P 500 reference it in their reports. *(Details, p. 32.)* But numerous other frameworks have sprung up, too, including the industry-led IPIECA (International Petroleum Industry Environmental Conservation Association) and the Global Real Estate Sustainability Benchmark (GRESB), as well as the topic-specific CDP (formerly the Carbon Disclosure Project) and the Task Force on Climate-Related Financial Disclosures (TFCD). Recently added to this landscape are the earlier-mentioned SASB and IIRC, which push for integrated reporting of financial and sustainability information. *(See below for more information on these frameworks.)* Each effort seeks to influence corporate sustainability disclosure and, to some extent, behavior toward what each asserts should be the benchmark in their area.

In reviewing which reporting models the companies were most frequently using, Si2 focused on the following existing models: the GRI, SASB, IIRC, SDGs and CDP. Si2 focused on the IIRC and SASB models to gauge the companies' level of acceptance of integrated reporting. We considered any references to these models in the companies' sustainability reports served to indicate IIRC and SASB influence in shaping integrated reporting. The GRI, as explained earlier, remains a dominant force in sustainability reporting; CDP, while not a model for a triple-bottom line reporting, has been most influential in the proliferation of key climate related disclosures. Si2 also looked at the SDGs as a reporting model—which in practice meant that the companies were adding an information index in their reports—to assess the companies' initial response to the newcomer. In addition to these models, Si2 tallied other sustainability reporting models that the companies had referenced. *(These findings appear on page 32.)*

First, below are brief descriptions of each of the reporting models mentioned in this report. *(More in-depth background information on the SASB and IIRC models is on pp. 19-24).*

GRI—The GRI has established itself as the most common framework for sustainability reporting. Headquartered in Amsterdam, GRI started as a project of the Ceres coalition in 1997. After the UN Environmental Program partnered with it in 1999, GRI released its first set of reporting guidelines, became independent in 2001 and moved to Amsterdam in 2002. Since then, periodic and comprehensive global consultations have produced revised iterations of the framework. GRI says its guidelines are applicable to organizations "regardless of their size, sector or location." The guidelines establish an international reference for stakeholders to assess reporting companies and other organizations. GRI is committed to the idea that disclosure drives management, although it does not rate or evaluate disclosure or the sustainability performance of reporting companies.

GRI released its latest update, the "GRI Standards" in October 2016. The Standards did not include significant changes from the previous version but included clarifications and greater emphasis on disclosure of management approach to sustainability. It is divided into two general sections: 1) Universal Standards, which applies to all organizations and addresses general disclosure topics as well as management approach, and 2) Topic-Specific Standards, which provide reporting guidance on economic, environmental and social topics from which a company can select only the content deemed material. GRI also provides sector-specific supplemental guidelines that companies can choose to use.

While the GRI presents an intricate map of corporate sustainability reporting, it also provides room for flexibility by allowing companies to report "based on" or "in accordance with" the guidelines. This flexibility has helped GRI-based reporting expand around the world, although most companies continue to report "based on" the model and a wide range of report content and quality exists in that spectrum.

CDP—Formerly the Carbon Disclosure Project, CDP gathers information on companies' environmental performance metrics in an annual survey that allows investors to compare company performance on the same metrics. CDP collects information from the world's largest companies on their greenhouse gas emissions and climate change strategies, but it also has expanded to include water and forests. CDP's Climate Program, still the central operation of the group and the most impactful to corporate disclosure, operates on behalf of some 650 institutional investors, representing assets worth more than $87 trillion. Just 235 companies responded to CDP's inaugural survey in 2003, but its latest iteration of the climate survey in 2017 received almost 1,100 responses from companies. Survey responses are available online on the group's database, each with a rating based on the company's climate performance and disclosure.

SDGs—As briefly mentioned in the background section of this report, in September 2015 193 countries adopted the **Sustainable Development Goals** (SDGs)—a 17-point agenda designed to address the most pressing global development challenges, to be achieved by 2030. These ambitious goals build on previous attempts by the United Nations to devise a collective plan to solve the world's problems, and followed the Millennium Development Goals, an agenda intended to be achieved by 2015, which had haphazard results. The 2030 SDGs were developed with input from the private sector, in recognition of its important role in global development. Many UN bodies have made it their latest mission to embrace and support the SDGs. Spurred by the imminent threat of global warming, the UN's latest goal-setting agenda has gained considerable traction among governments, NGOs and businesses globally.

The 17 SDGs are divided into a total of 169 targets and 230 indicators, meant to help measure specific progress. *(See page 31, Figure 12 for a complete list.)* The indicators are designed to help monitor progress against the targets and the broader goals. International organizations working to build momentum for the SDGs in the business community have pushed companies to use the framework as a disclosure model, adding another dimension to their engagement toolbox. The GRI, which has supported SDGs-based reporting as a complement to its own model, published guidance on how to do so in August 2018. While it remains to be seen how this will play out in practice, Si2's research finds that some companies have already started to include the SDGs as part of their sustainability reporting indexes. *(See page 32 for these findings.)*

In addition to the above, the following guidelines were most cited by reporting companies:[12]

The UN Global Compact—The UNGC calls itself "the world's largest corporate sustainability initiative." As part of its continuing efforts to involve the private sector in advancing its agenda and sustainable development, the UN in 2000 launched this set of broad principles. The Compact is neither a code of conduct nor a reporting scheme; it calls itself "a strategic policy initiative for businesses." Its 10 principles address human rights, labor, the environment and corruption, incorporating key concepts from the Universal Declaration of Human Rights, the International Labor Organization core conventions, the Rio Declaration on Environment and Development and the UN Convention Against Corruption. Companies that sign on are to use its principles to organize and develop their sustainability strategies. The Compact has formed a strategic partnership with GRI and encourages its signatories to use the GRI Guidelines to fulfill the annual Communications on Progress (COP) reporting requirement. Most recently it has turned its focus to supporting the mission of the SDGs, working with companies on various aspects of the goals.

IPIECA—Originally the International Petroleum Industry Environmental Conservation Association, it says it is "the global oil and gas industry association for environmental and social issues." It is an industry association dedicated to improving the environmental and social performance of member companies; its latest guidance on sustainability reporting came out in September 2015. It says its disclosure topics were chosen based on industry consensus and cover 12 sustainability issues and 34 indicator categories across environmental, health and safety and social and economic issues.

EEI—Similar to the above is a new framework set forth by the Edison Electric Institute, an industry association for electric utilities in the United States. This framework is so new that the organization only just made its announcement in August 2018, although Si2 found a number of companies that had participated in its pilot disclosure based on a template published in December 2017. The target audience for this new framework is electricity customers and investors, according to the group's press release; the model includes emphasis on both qualitative and quantitative information on ESG issues, it says.

GRESB—The Global Real Estate Sustainability Benchmark. GRESB, is set up as a private limited company based in Amsterdam but is a collaboration among some of the world's biggest pension funds—including the California Public Employees' Retirement System (CalPERS) and the Development Bank of Japan—and academic institutions. It says that its purpose is to help companies apply the ESG framework to real assets. The group assesses the sustainability performance of real estate and infrastructure portfolios and assets worldwide, offering ESG data, scorecards, benchmark reports and portfolio analysis tools. The GRESB Real Estate Assessment serves as a benchmarking and reporting tool for companies managing properties; its framework covers seven sustainability aspects and about 50 indicators. GRESB says on its website that 903 property companies, real estate investment trusts (REITs), funds and developers participated in this assessment in 2017, up 6 percent from the previous year.

[12] Si2 chose to present only those models referenced by more than 9 reporting companies.

Integrated Reporting Models Push the Envelope

Added to the abundance of frameworks in the last few years are those offered by the IIRC and SASB. Each presents a different model for companies to disclose sustainability information alongside financial data. Although seemingly at opposite ends of approach, they actually complement each other. Indeed, as evidenced in a memorandum of understanding (MoU) signed in late 2013, the two organizations have sought to collaborate in advancing corporate integrated reporting and to share certain fundamental principles about the topic. For example, both organizations acknowledged that integrated reporting is about companies communicating how they create value over time. *(Box, right.)* The IIRC's mission was to "create *the* globally accepted" integrated reporting framework, it said, while SASB was focused on "the development and dissemination of industry specific sustainability accounting standards." SASB's work was "an important stepping stone towards the practical implementation of the concept of (integrated reporting) in the USA," according to this memo; more recently, SASB has expressed interest in international applicability of its concept, as well.

Integrated Reporting ('IR') is a process that results in communication by an organization, most visibly a periodic integrated report, about value creation over time. An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.

— IIRC and SASB, 2013 MoU

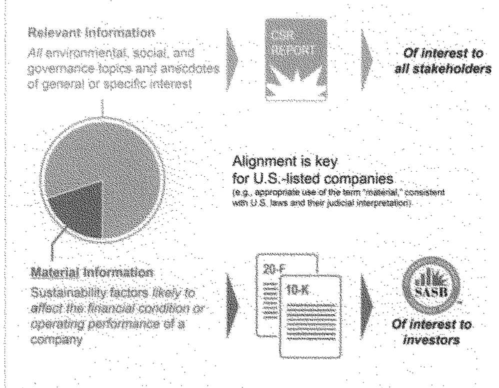
Despite the above-expressed intention to collaborate for a common goal, each organization's approach has been very different. This is worth understanding because, at first glance, the two models seem to compete with each other. Given the inherent complexities on both sides, it is difficult to quickly discern how the two can work together. The following sections of this report therefore briefly describe each approach and compare them.

Sustainability Accounting Standards Board (SASB)

In the United States, the non-profit SASB is in the final stages of developing its sustainability accounting standards, soon to be codified for usage. This will mark the end of a three-year process involving rigorous research, stakeholder feedback and updates on its new accounting standards. A careful review of the group's website does not produce a concise definition of integrated reporting, however. Rather, the group has been focused on developing specific guidance on *how* companies can integrate material sustainability data into existing channels of information for investors, so they may easily find verified, comparable information. SASB's unique strength is in its industry-specific standardization of quantitative, sustainability metrics—addressing an important pain point for investors described earlier. Already, a 2016 survey from PricewaterhouseCoopers shows U.S. investors' preference for SASB (43 percent) over GRI (21 percent) for corporate ESG reporting, which illustrates its influence.

Background: With roots going back to the Initiative for Responsible Investment at Harvard University, SASB launched a method to identify material sustainability factors for six industries in 2010. It formally incorporated in 2011, with a mission "to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors." It says in its *Rules of Procedure* that it aims to "enable the standardized measurement and disclosure of corporate performance on the most critical sustainability factors—those that are reasonably likely to have material impacts on the financial condition or operating performance of a company," which it says will enable better decisions by companies and their investors. SASB also says that its standards are "aligned" with

Figure 4: SASB Model of Non-Financial Reporting



existing securities laws such as in Regulation S-K, , the legal requirements that companies must disclose "known trends, uncertainties, and events that are reasonably likely to have a material impact on [their] financial condition or results of operations." Implied in SASB's purpose is the inclusion of sustainability data in companies' financial filings, even though the standards' usage remains voluntary.

In March 2016, SASB finished issuing provisional standards for 79 industries in 11 sectors, following its own *Sustainable Industry Classification System (SICS)*, which categorizes global businesses according to their resource intensity and sustainability impact. The sectors are:

- Health care
- Financials
- Technology & Communications
- Extractives & Minerals Processing
- Transportation
- Services
- Resource Transformation
- Food & Beverage
- Consumer Goods
- Renewable Resources
- Alternative Energy
- Infrastructure

SASB's latest public consultation phase—designed to elicit feedback on the standards' materiality, cost effectiveness and decision-usefulness—ended at the end of January 2018. It received more than 120 letters from 97 commenters, including companies, investors, industry associations and others across all its sectors. SASB responded to the public comments and codified the standards, which it released on November 7, 2018.

Key concepts: SASB says on its website that sustainability accounting reflects a company's management of its environmental and social impacts as well as its "environmental and social capitals necessary to create long-term value." This includes the impacts that sustainability challenges have on innovation, business models and corporate governance, which lead to the following major sustainability areas:

- **Environment**—Includes environmental impacts that may affect the company's financial condition or operating performance, such as greenhouse gas emissions, air quality, water and waste management and ecological impacts.
- **Social capital**—Relates to the expectation that a business will contribute to society in return for a social license to operate. It addresses the management of stakeholder relationships, such as community relations, human rights, access and affordability, as well as data privacy and security.

- **Human capital**—Addresses the management of a company's human resources as key assets to delivering long-term value, including labor relations, compensation, employee health and safety, as well as engagement and diversity.
- **Business model & innovation**—Addresses the integration of environmental, human, and social issues in a company's value creation process. Includes issues such as product design and life cycle management, product packaging and distribution, supply chain management, material sourcing and business model resilience.
- **Leadership & governance**—Involves the management of issues that are inherent to the business model or common practice in the industry and that are in potential conflict with the interest of broader stakeholder groups, and therefore create a potential liability or a limitation or removal of a license to operate. Includes issues such as ethics, competitive behavior and critical incident risk management.

SASB also sets forth a number of important principles that guided its standards-setting process, such as the potential to affect corporate value, interest to investors, relevance across the industry, actionability by companies and reflective of stakeholder consensus. SASB's disclosure topics for all industries are posted its website.

Materiality: Central to SASB's approach is the concept of materiality. According to the U.S. Supreme Court, information is material when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." SASB says that its standards "address the sustainability topics that are reasonably likely to be material and to have material impacts on the financial condition or operating performance of companies in an industry," using the definition of "materiality" under U.S. securities laws. Its standards, then, are designed to be integrated into companies' financial filings such as the Management's Discussion and Analysis section or in other relevant standardized, required sections of Forms 10-K or 20-F.

Remaining challenges: As noted earlier, SASB enjoys an early welcome by investors and companies as a source of corporate ESG information. Si2's research shows that a surprising number of U.S. companies seem to be already paying attention, even before the standards are formally codified. *(See p. 32.)* But the elephant in the room is that SASB's target disclosure is through mandatory disclosure, and there is no indication that companies are willing to take on this additional burden anytime soon. Nor is there any indication that it will be required by legislation or regulation in the near future, particularly given the Trump administration's consistent opposition to regulation and corporate disclosure requirements about information outside traditional financial assessment.[13] Without broad adoption and consistency in reporting, the relative strength of the SASB model, that investors will be able to compare performance apples-to-apples, is weakened.

The IIRC Framework

The International Integrated Reporting Council (IIRC) is based in London and includes a coalition of regulators, investors, companies, standards setters, accounting professionals and civil society organizations working toward a global framework for integrated reporting. IIRC-based integrated

[13] Since taking office in January 2017, President Trump has effectively halted two disclosure rules on business and human rights resulting from the Dodd-Frank Act: the conflict minerals rule and payments to governments by resource extractors.

reporting has seen recent momentum globally. According to KPMG's analysis of corporate responsibility reports, about 14 percent of the world's largest companies issued integrated reports in 2017; about two-thirds of them referencing the IIRC framework.

IIRC aims to "establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors." Its vision is "to align capital allocation and corporate behavior to wider goals of financial stability and sustainable development through the cycle of integrated reporting and thinking."

Key concepts: The IIRC launched its framework in December 2013 with overarching "Guiding Principles" *(box below)* and eight "Content Elements." The two are "fundamentally linked" and "not mutually exclusive." *(IIRC's framework for value creation process is illustrated in Figure 5, next page.)*

Principles-based approach—Unlike SASB's sustainability accounting standards, IIRC's framework does not lay out for companies exactly what to report in key performance indicators or measurement methods. Rather, IIRC says that it takes a "principles-based approach," to "strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs." IIRC leaves companies to determine which indicators are material and how they should disclose information. It does not necessarily advocate that companies include integrated reports as part of their compliance with current disclosure requirements, although it acknowledges that they may do so, and says that integrated reports could be presented separately or as a "distinguishable, prominent and accessible part of another report or communication."

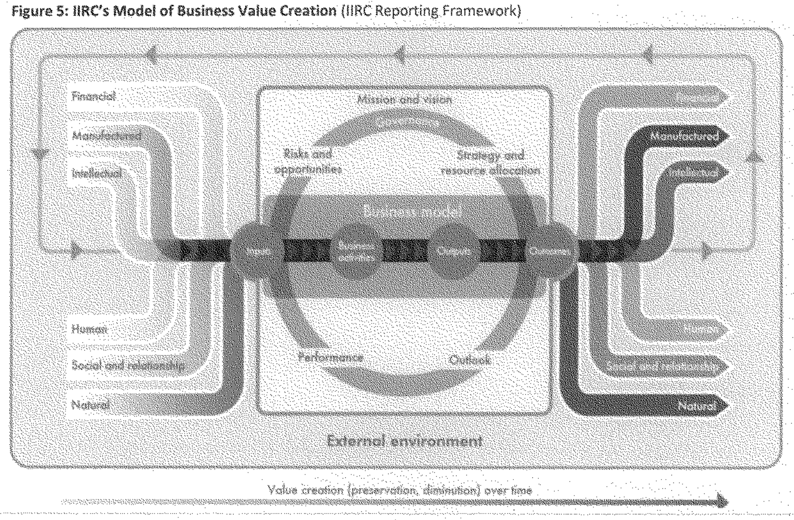
IIRC Guiding Principles

- **Strategic focus and future orientation:** An integrated report should provide insight into the organization's strategy, and how it relates to the organization's ability to create value in the short, medium and long term, and to its use of and effects on the capitals
- **Connectivity of information:** An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time
- **Stakeholder relationships:** An integrated report should provide insight into the nature and quality of the organization's relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests
- **Materiality:** An integrated report should disclose information about matters that substantively affect the organization's ability to create value over the short, medium and long term
- **Conciseness:** An integrated report should be concise
- **Reliability and completeness:** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error
- **Consistency and comparability:** The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) in a way that enables comparison with other organizations to the extent it is material to the organization's own ability to create value over time.

Emphasis on value creation—Integrated reporting based on the IIRC framework looks at corporate sustainability through the lens of value creation, providing insights about:

1. the *external environment* that affects an organization;
2. the *resources and relationships* (or capitals)—including financial, manufactured, intellectual, human, social and relationship, and natural—used and affected by the organization; and
3. how the organization interacts with the *external environment* and the capitals to create value over the short, medium and long term.

Figure 5: IIRC's Model of Business Value Creation (IIRC Reporting Framework)



Remaining challenges: Despite IIRC's success in many international markets, its adoption in the United States has been at a snail's pace. The flexible approach that IIRC takes may be a hindrance as well as a strength. Companies that may have been influenced by the IIRC framework and its principles may not reference or declare it—the GRI guidelines, for example, instructs companies to acknowledge use of its framework—making it difficult to measure its real influence. IIRC's website currently lists 17 companies across North America whose reports have been influenced by it. The list includes **American Electric Power (AEP), Eli Lilly, Entergy, GE, Nisource, PGE, Praxair, Prudential Financial** and **Clorox** in the United States. But Si2's research suggests only four of these firms in the S&P 500—Intel, **Pfizer,** Prudential Financial and Praxair—actually reference IIRC. *(See Table 5, p. 35 for more.)*

Comparing Major Reporting Frameworks

Even though the GRI, IIRC and SASB each take a different approach, and while the landscape is crowded with alternatives, there remains plenty of room for the three frameworks to work together to enhance companies' sustainability disclosures. All three approaches have the same broad purpose: each seeks to promote a world in which companies behave as responsible citizens, acting more holistically, measuring and reporting on their actions. But each model presents a different path, allowing companies to choose or combine what they want to follow. The table below *(next page)* highlights the differences between the three models.

Table 1: Comparison Chart of SASB, IIRC and GRI Reporting Models

	SASB	*IIRC*	*GRI*
Type of Guidance	Standards	Framework	Standards
Scale	U.S. Focus.	Global	Global
Scope	Industry specific	General	General & specific for some sectors
Target Disclosure	Mandatory filing	Flexible	Voluntary sustainability report
Target Reporters	Publicly traded companies on U.S. exchanges[14]	Publicly traded companies around the world	Public and private companies and organizations around the world
Target Audience	Investors	Investors	All stakeholders
Central Emphasis	Quantitative metrics for material ESG topics	Corporate value creation over time & ESG integration into strategy	Qualitative and quantitative ESG disclosures
Definition of Materiality	Information is material if "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of the information made available." (U.S. Supreme Court U.S. Supreme Court definition)	"A matter is material if it is of such relevance and importance that it could substantively influence the assessments of providers of financial capital with regard to the organization's ability to create value over the short, medium and long term." (IIRC definition)	Information that "may reasonably be considered important for reflecting the organization's economic, environmental and social impacts, or influencing the decisions of stakeholders" (GRI definition)

Source: Modified from SASB website with information from IIRC and GRI websites

Si2 found in this project that leading companies do not follow just one framework, but instead take guidance from multiple sources, with 182 out of the S&P 500 referencing at least two reporting frameworks. *(More on p. 32.)*

ESG Raters Use of Data and Current Views on Integrated Reporting

Recent webinars, conference panels and meetings in mid-2018 exemplify current thinking from ratings agencies about sustainability reports, and their views on integrated reports, locating these within the ecosystem of ESG data and ratings. The Conference Board convened a working group on integrated reporting, in collaboration with PricewaterhouseCoopers (PwC), and met starting in January 2018 to explore the practice further; this section reports on those discussions. To further draw back the veil on what drives companies to report as they do, Si2 also interviewed two companies that produce integrated reports, uncovering their very different conclusions.

Raters: At a May 2018 webinar hosted by US-SIF, the SRI industry association, representatives from leading rating firms discussed the current state of ESG ratings and data availability. Diederik Timmer, Sustainalytics' Executive Vice President of Client Relations stressed that his firm is always looking for

[14] While SASB says its standards may be used in international markets, it has primarily focused on rolling out the model within the United States thus far.

material, forward-looking information about the companies it examines. He stressed ESG data provide a "sniff test" for analysts, and that sustainability reporting shows the extent to which companies have integrated ESG into their businesses. Jon Hale, Director of Sustainable Investing Research at Morningstar Research Services, and Laura Nishikawa, Executive Director of ESG Research at MSCI, both emphasized what they see as a need for more corporate transparency about ESG data in general, in whatever form companies provide it. All three firms have their own approaches to using ESG data and all are agnostic about where information comes from; they simply want more of it. Nishikawa pointed to an "evolution" in data quality assessment, and MSCI's attempt to define "ESG momentum," with ESG changes over time producing a performance signal. She noted, however, that it is difficult to gauge company intentions.

Companies and investment advisors: The annual US-SIF conference in late May 2018 featured a panel with two company sustainability officers and two investment advisors, discussing company ESG data reporting, data use and intermediaries' role in the data ecosystem. David Tulauskas, **General Motor's** Director of Sustainability, said his company's reporting must serve investors, help attract talented prospective employees, inform civil society groups and satisfy governments. Picking up the theme of momentum raised by MSCI's Nishikawa, David Stangis, Chief Sustainability Officer at **Campbell's Soup**, said his company is looking beyond corporate footprint metrics to understand where data users are headed in their lines of questioning; he said the next horizon is using ESG data to measure business opportunity, and to drive competitive advantage—underscoring the material impact potential for ESG factors. Noting the challenges investors face, Duane Roberts of Dana Investments Advisors also pointed out that the ratings offered by MSCI and Sustainalytics, the two main U.S. ESG data providers, correlate to one another only about 40 percent of the time, making it necessary to cast a wide data net. Roberts also said ESG information helps to identify investment opportunities. Jessica Urdangarin, another panelist, from investment advisor Brown Flynn, said her firm advises "integrated thinking" by companies, which GM's Tulauskas believes is coming—although Stangis was not sure data users' thirst for ESG will be quenched by integrated reports.

The Conference Board working group: In collaboration with PwC, The Conference Board convened a working group of its members and experts to explore the current state of integrated reporting.

Raters and views about them—At a June 2018 meeting, raters offered their thoughts about the pros and cons of the practice. One rater participant saw significant benefits for raters, in that these reports give more visibility in general to sustainability information and are more likely to contain data verified by external assurers, a key benefit. But she cautioned that integrated reports also give less space for ESG information and are more likely to emphasis a corporate vision rather than data, a problem for raters. Another rater pointed to "intense and rapid" interest in integrated reporting in Asian markets, but also noted that corporate voluntary disclosure accounts for only about 30 percent of her firm's rating. She stressed the need for reports to focus on the most material key performance indicators, from an investment perspective, and opined that integrated reports tend to produce the most useful information in this regard. She also noted that her firm considers the factors companies think are most important to them—and sees externally audited ESG data as of particular interest to ratings clients.

A large operating company representative questioned whether integrated reports are just a matter of form over substance, while a leading asset owner suggested that if ESG factors are built into business considerations from the start, corporate social responsibility staff can focus less on gathering data and more on other tasks. A major accounting firm participant offered the view that better corporate reporting would help cut out information intermediaries that may use less accurate information. An industry group participant also said the ongoing consolidation of ratings firms may address the problem of survey fatigue among companies, in concert with metrics consolidation.

A major mutual fund firm representative underscored the view of raters—that more information offered by companies is usually better than less, and that it must be publicly disclosed. She also said the ratings firms' scores are helpful for sorting through the mass of data that is on offer, helping portfolio managers when clients express particular interest in ESG awareness in their investments. Yet she also said metrics standardization is laudable; further, she felt ESG metrics are particularly helpful in mitigating downside risk. Picking up the theme of ESG momentum and signaling, a large asset manager said his firm is "all in" on the concept of ESG factors indicating better corporate management, which can be particularly true for small- and mid-cap companies. Integrated reports really help his firm's "deep engagement" with management, he said, because they cut through "pervasive greenwashing" and are more concise.

Materiality—In September, The Conference Board working group met to consider current thinking about materiality and integrated reporting. Information is material if a "reasonable investor" thinks it is important, but as a corporate law expert noted, the precise nature of what is material is "a mixed question of law and fact"—which becomes an issue in integrated reports. He said the emphasis now is on value drivers, which vary by sector, but pointed out that securities laws often define materiality as matters related to financial performance. This can be in a quantitative sense, but a qualitative aspect also must be considered. The group considered how definitions of materiality may be affected if securities buyers look beyond financial performance, and what other sustainability outcomes they find relevant to buy/sell decisions. Another legal expert observed that there is no requirement from securities laws to disclose everything that is material, and said assessments of materiality usually end up being an after-the-fact exercise. A corporate attorney from one of the largest U.S. companies sees securities class action lawsuits as a large threat, noting negative outcomes for companies when investors are harmed by the omission of data that negatively affects company financial performance. Still, he said there is a fine line between what is financially material and what is otherwise of interest to the "reasonable investor." His firm is trying to report less but more meaningful information. He also noted his firm tends to proactively disclose to allow executives to engage in meaningful conversations with investors and not violate fair disclosure laws. Speaking to the issue of value drivers, the company lawyer says his test is three-fold: if the company is asked about something, if disclosure about it would surprise anyone, and if there is any previous disclosure history.

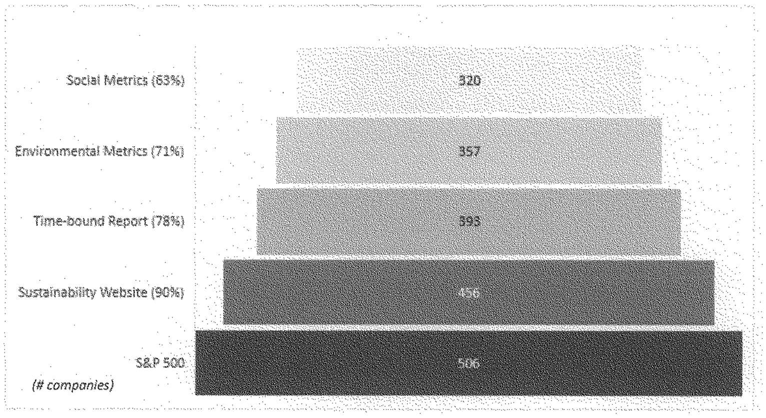
The group concluded that the "total mix of information" investors may consider to be material has grown, and that its inclusion in securities filings (such as those vetted externally in integrated reports that include financial data) is costlier. Participants seemed to agree that multiple types of reports may provide the best solution for reporting, not just a one-size-fits-all report. A GRI report might speak to a wide range of stakeholders, beyond investors, while an integrated report using SASB metrics would focus primarily on investors. A proponent of integrated reporting said these types of reports represent a better, more evolved financial report about value creation, which ultimately lowers the cost of capital for companies and makes markets operate more efficiently, because they reflect better corporate strategy.

II. 2018 Findings

State of Sustainability Reporting, 2018

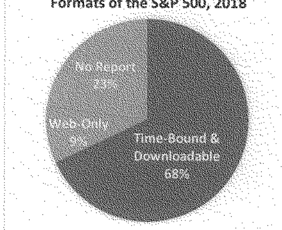
Majority reports on sustainability: An overwhelming majority of companies in the S&P 500 (92 percent), offered sustainability information on their websites, although not all included a comprehensive report. A total of 395 companies (about 78 percent) issued sustainability reports, although when it comes to offering real ESG performance metrics, the rates fell, with 357 including environmental metrics and only 320 social data. *(Figure below.)*

Figure 6: Sustainability Information Offered by the S&P 500, 2018



Most reports were downloadable: Companies are most likely to use a discrete, downloadable and year-specific report (68 percent), but 9 percent offered information in a web-only format (with unclear parameters that may change over time). The static, time-bound reports help stakeholders locate data in a time series, and usually companies that offer these provide past reports on their websites as an archive, making historical data available to those interested. These also tend to follow a more defined structure that is comparable between report versions. While we distinguish between these two formats, most companies actually use some combination of the two, with both static material (full reports, summary brochures, performance data tables, or a GRI index) and web-based presentations. Companies sometime include only a few ESG performance metrics but use multiple reporting formats, muddying the overall distinction; Si2 sought to capture a big-picture snapshot.

Figure 7: Sustainability Reporting Formats of the S&P 500, 2018



Most reports are annual: About 93 percent of the 395 sustainability reporters issued time-bound reports. The dominant majority of reporters (87 percent) publish their reports annually, while 6 percent report biannually and two companies—**Mattel** and **Costco**—do so every three years. For 26 companies (7 percent), all web-only reporters, it is unclear how often content is updated, highlighting a key weakness of this format.

Table 2: Sustainability Reporting Rates among Sectors, S&P 500

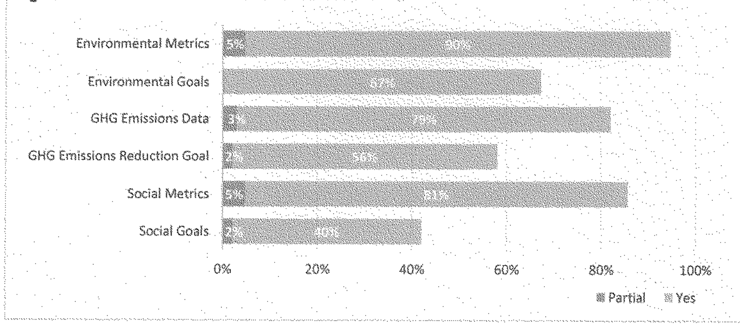
Industry (GICS)	*Total # Cos.*	*Reporting Rate*
Telecommunication Services	3	100%
Consumer Staples	32	97%
Utilities	27	96%
Materials	25	96%
Industrials	59	84%
Energy	26	84%
AVERAGE		83%
Health Care	46	74%
Real Estate	24	73%
Financials	49	71%
Information Technology	48	70%
Consumer Discretionary	56	68%

High reporting by most sectors: Among the 11 sectors represented in the sample, just one—*Telecommunications*—had a 100 percent reporting rate, although there are only three companies in it.[15] Consumer Staples, Utilities and Materials were not too far behind, all with reporting rates in the high 90-percent range. The least likely to report are *Consumer Discretionary* firms, with 68 percent doing so. On average, 83 percent of the entire index reports. *(See table above.)*

Quality of Reports Varies

Most include ES metrics: The quality of report content varies widely. Si2's basic assessment was whether report offer specific environmental and/or social (ES) performance *metrics* and *goals*. While most reporting companies offer at least some ES performance metrics, the number that articulate goals is far lower, especially for social issues. More specifically, Si2 found that:

Figure 8: Environmental & Social Metrics and Goals



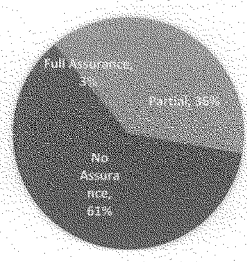
[15] Si2 used the Global Industry Classification Standard (GICS)

- Most reports (95 percent) offer environmental performance *metrics* (quantified measures that are comparable year-over- year), while 67 percent set quantified and time-bound environmental *goals*.
    - 313 companies (nearly 80 percent of reporters) disclose *greenhouse gas emissions (GHG) data* in absolute numbers, with another 10 (3 percent) earned "partial" credit in the assessment for offering GHG intensity figures. A total of 223 companies (56 percent) of reporters set time-bound *GHG reduction goals*, either in absolute or carbon intensity reductions.
- Most reports (86 percent) offer *social performance metrics*, although Si2 cast a wide net and gave full credit for the most common social metrics including injury and accident rates. *Goal-setting for social performance* is relatively low, coming from just 40 percent of reporting companies.

(See Figure 8, previous page, for bar graph with findings.)

Most lack external assurance: The quality of report content drops further when it comes to third-party assurance of the sustainability data presented. A minority (about 38 percent) of reports obtain external assurance, and 90 percent of these pertain only to some data, in most cases GHG emissions. *(See pie chart below.)*

Figure 9: External Assurance of Sustainability Reports



Only 3 percent of reporters assert their reports or ES performance data are completely externally verified, although even then ambiguity exists given the varying language companies use and how much transparency they offer about auditing. For example, some companies said their "report" was externally verified, explaining that a third-party reviewed the company's accounting methods for providing the information but did not necessarily verify the ES performance data were accurate. Still other companies stated that their ES metrics were reviewed by multiple assurers through a process that included site visits.

The issue of external assurance is clearly a key pain point for investors, who have consistently complained about the lack of external verification of sustainability data, as noted above in this report. Varying standards and the haphazard nature of the current state of external data verification hinders stakeholders' evaluation of company performance and gets in the way of more robust analysis of comparable metrics among peer groups.[16] *(Appendix, part 2, p. 41, lists companies that provide full external assurance and quotes the language they use to describe the process; Appendix, part 3, p. 44, lists external auditors most commonly used by S&P 500 sustainability reporters.)*

[16] An IRRCI/CFA survey in 2015 found that CFA Institute members were split about what level of independent ESG data verification they thought was needed, with 44 percent favoring an approach similar to a formal audit and another 46 percent satisfied with more limited assurance. See https://irrcinstitute.org/wp-content/uploads/2015/09/FINAL-CFA-ESG-Study-August-20151.pdf.

Less than two in three provide a materiality analysis and report on a stakeholder engagement process: SASB has zeroed in on materiality in its assessment, a familiar concept to investors, bridging the gap between public policy-oriented sustainability discussions and the investment world. As illustrated above *(p. 24)*, each of the major reporting models covered in this report provides a broadly similar definition of materiality, which is that disclosed sustainability information should have relevance to the judgement and decision-making process of investors or stakeholders. Si2 examined materiality analysis disclosures to see how companies are thinking about their environmental, economic and social impacts and if that thinking includes considerations for business strategy, which can help investors and other stakeholders see if and how ESG factors are included in business planning.

Figure 10: Materiality Analysis among Sustainability Reporters, S&P 500

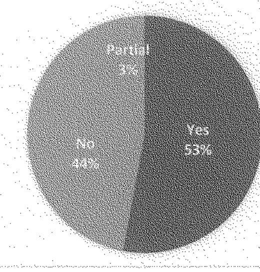
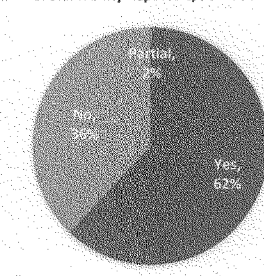


Figure 11: Stakeholder Analysis among Sustainability Reporters, S&P 500



Disclosure of a stakeholder engagement process also is an element in the GRI reporting model. It teases out how a company is working to gather independent feedback from those outside its organization. Stakeholder engagement go hand in hand with a materiality analysis, since the first often is a key tool for the latter.

Just over half of the 395 reporting companies in the 2018 S&P 500 (53 percent) include a materiality analysis in sustainability reports; another 11 companies (3 percent of reporters) provide some information about materiality analysis but not a complete accounting; these earned "partial" credit in the Si2 analysis. About 62 percent of reporting companies reported on the stakeholder engagement process; another 2 percent received "Partial" credit.

Alignment with UN Sustainable Development Goals (SDGs)

As noted, the SDGs are a set of 17 goals the UN set forth in 2015 to address the most pressing global development challenges, to be achieved by 2030. The goals range widely from alleviating hunger and poverty to tackling climate change. *(See Figure 12, next page.)* Many international organizations have made the SDGs a part of their missions. In the investment world, this includes the UN Sustainable Stock Exchanges (SSE) Initiative mentioned earlier and the Global Compact; each has pledged to enlist the business community in support of the SDGs. In response, many companies have started to disclose how their sustainability efforts align with the SDGs.[17] Si2 used mention of the SDGs as a proxy for each company's level of awareness about the external environment and its role as a corporate citizen. *(Some*

[17] This is different from using the SDGs as a disclosure framework, which Si2 discusses below. When companies identified how their sustainability strategies aligned with the SDGs, they dedicated space in the management section of the report and listed a selection of SDGs on which they had decided to focus.

Figure 12: The 2030 U.N. Sustainable Development Goals

companies also have begun using the SDGs in their sustainability reporting indexes, and are using its disclosure framework for disclosure, as explored in more detail below.)

Si2 found that among the 395 companies that issue sustainability reports, 103 (26 percent) note or map out how their sustainability strategies align with the SDGs. Another 16 companies (4 percent) acknowledge the SDGs in their reports without mapping out where their goals align with the UN effort.

Picking and Choosing Frameworks

Si2 focused on prominent sustainability reporting models in assessing the S&P 500—the GRI, SASB, IIRC, SDGs and CDP *(discussed pp. 16-18)*. The assessment tallied up which frameworks are most frequently cited and found that in most cases, companies do not commit to just one model and instead issue reports that combine the style, format and content from several approaches.

Table 3: Number of Sustainability Reporting Models Used, S&P 500

No. of Models Used	*Count of Reporter*
6	1
5	10
4	14
3	53
2	104
1	116
0	97
Total	395

Most reporting companies, or 385 out of 395 (97 percent), chose customization and a unique style over following any one reporting framework closely. Less than 3 percent (just 10 reporting companies) only followed either the GRI or one of the industry-led reporting models closely, without using another as well. About 97 companies (25 percent of reporters) did not reference a specific framework.

- **GRI** remains the most used reporting framework for sustainability reports, with 60 percent of all reporters referencing or following it. Si2 categorized those companies that were providing a brief GRI index at the end of the report as "referencing" the model, counting only those that followed the framework closely as "following" it. About 6 percent of all reporters (23 companies) belong to this latter category.

- **CDP** is the next most-referenced framework, used by 49 percent of sustainability reporters—although it is limited to environmental issues, and more specifically, to climate change.[18]
- 49 companies (12 percent) provide a disclosure index for **SDGs**, helping stakeholders to easily track information related to the goals. This is notable as the SDGs are only three years old.
- 35 companies (9 percent) reference **SASB**, illustrating its remarkable influence even though its final iteration was not yet final when research for this project was conducted.
  - Notably, **Digital Realty Trust** does not issue a standalone report on sustainability but includes in its 2017 Form 10-K a selection of energy- and water-related performance metrics derived from SASB's Real Estate Owners, Developers & Investment Trusts Sustainability Accounting Standard guidance.
- Only four companies reference **IIRC**, although its influence could be greater than that small number would imply, as discussed in more detail below. The relative lack of uptake by U.S. companies understates the extent to which it is gaining ground in other global markets.

In addition to the above models, reporting companies referred to numerous other frameworks, mostly industry- and/or issue-specific initiatives. Those referenced by more than nine companies are listed on Table 4 *(right)*; in addition to these, three companies referenced the UN Guiding Principles Reporting Framework, specific to human rights.

Table 4: Other Sustainability Reporting Models Used, S&P 500

Model	*Count of Reporters*
UNGC	33
IPIECA	15
EEI	11
GRESB	9
TCFD	9

Increasing Inclusion of Sustainability in Financial Reports

Almost 40 percent of the S&P 500 now voluntarily address some aspect of sustainability in their financial reports, although the nature and extent vary widely. Si2 reviewed the annual reports, Forms 10-K and proxy statements of the 506 companies in the S&P 500 to broadly measure the inclusion of sustainability information.[19] In making this assessment, Si2 did not judge the quality or quantity of such information, but examined letters from board chairs in annual reports and voluntary sections about sustainability in the 10-Ks to see if sustainability issues were addressed. (Compliance related information typically offered under "Environmental Matters" or "Risk Factors" sections was not counted.) In proxy statements, Si2 counted information outside governance-related discussion of board committees and executive compensation, and examined board oversight of sustainability separately.

- A total of 118 companies (23 percent) voluntarily address sustainability in *10-Ks*; another 80 companies (18 percent) do so only in *annual reports*. In all, about 40 percent of the S&P 500 now include voluntary sustainability discussion in their annual reports or 10-Ks.
  - When looking at the pool of sustainability reporters, 181 companies (46 percent) include voluntary sustainability information in their *10-Ks* or *annual reports*.

[18] Disclaimer: Si2 only counted when companies attributed using the CDP framework in their own sustainability reports, consistent with how it counted references to other models reviewed. Because survey responses to CDP are housed outside of the company's own website, Si2 did not count, for example, when a company did not issue a stand-alone sustainability report but had responded to CDP.

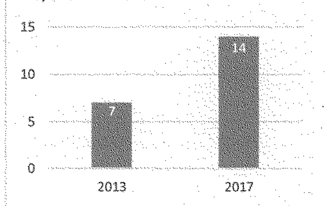
[19] When Si2 accessed the list of S&P 500 in the beginning of 2018 it included a total of 505 companies; we further separated out Dow and Dupont—which is listed as one entity after the merger but still had separate sustainability reporting practices—bringing the total number to 506.

- A total of 191 companies (38 percent) include discussion of corporate responsibility or sustainability in *proxy statements* above and beyond board governance and executive compensation disclosures. While the extent of these inclusions varies widely, Si2 found many proxy statements describe company sustainability efforts and goals—typically in a "proxy statement summary" prominently placed at the beginning of the filing. For example, **Bristol Myers Squibb** included a section on "Global Corporate Citizenship & Sustainability" in its proxy statement and outlined its sustainability philosophy and goals.
    - A total of 172 sustainability reporters among the S&P 500 (44 percent) include voluntary sustainability information in their *proxy statements*.
- A total of 212 companies (42 percent) disclose formally designated *board committee oversight* of sustainability issues, although specificity varies. While the nearly all (89 percent) of committees are directed to oversee both environmental and social issues, 12 companies (4 percent) must oversee only environmental issues and 20 companies (7 percent) only social issues.[20]
    - A total of 201 sustainability reporters (51 percent) formally designate a board committee to oversee sustainability issues.
    - Only 10 companies—**Western Union, Electronic Arts, LyondellBassell, Everest Re Group, Allegion, Mastercard, Biogen, Fortune Brands Home and Security, Travelers, Williams Companies** and **Cabot Oil & Gas**—have formal board committee oversight of sustainability issues *without* having issued a time-bound sustainability report.

State of Integrated Reporting 2018

Integrated reporting has not yet deeply penetrated the sustainability reporting landscape of U.S. companies. Even though a surprising number—35 companies—indicate that their reporting is influenced by SASB, most have of those have not yet issued integrated reports. In fact, the majority of companies that issued integrated reports in 2017 cited neither SASB nor IIRC. Even though Si2's research this year shows that integrated reporting has yet to establish a strong foothold in the S&P 500, corporate reporting has seen healthy growth and evolved to reflect some of the latest thinking, including that articulated by SASB and IIRC.

Figure 13: Integrated Reporters in the S&P 500, 2013 and 2018



In this section, Si2 looks in more detail at the small group of companies that have issued integrated reports, with most of them identified by self-declaration.

Number of Integrated Reporters Doubles

Overall, **14 companies issued an integrated report for their latest reporting periods, twice the number from 2013.** In 2013 Si2 found just seven companies issued integrated reports; five of these continued to

[20] An additional seven companies received "Partial" credit for this indicator. In these cases, the company had a board committee dedicated to an issue too narrow in scope to deserve a full credit, such as a committee with oversight on "patient safety" at a pharmaceutical company.

do so in 2018. *(See figure above.)* One that did not is **Dow**, which merged with DuPont and is in the process of splitting into three new companies; Dow's last full sustainability report in 2016 was integrated. The other, **Eaton**, has transitioned its report to a fully web-based format that focuses primarily on environmental and social performance metrics with no financial information.

This year's integrated reporters have the following key characteristics, summarized in Table 5 *(below)*:

- **Seven sectors out of 11 are in the group of reporters. Health Care** leads, with four firms; **Utilities** and **Industrials** are next, with three each.
- **The size of a company, measured in revenue, does not seem to affect decisions about issuing an integrated report**. The reporters' 2017 revenues ranged from almost $4.0 billion (**Dentsply Sirona**) to $120.5 billion (**General Electric**), and averaged about $30.0 billion.
- **Exposure to international markets also does not seem to influence integrated reporting decisions.** Si2 explored the hypothesis that increased preferences for integrated reporting in some international markets would prompt greater uptake by U.S. firms with more international business. But four companies with integrated report did not derive any income from abroad in 2017 and another earned just 3 percent of its revenue internationally; the average percentage of international revenue for the group was about 31 percent. While a closer examination might reveal otherwise, available data suggest that just having a presence in international markets does not seem to significantly affect a company's decision to issue an integrated report.

Table 5: Integrated Reporters of the S&P 500, 2018

Company	*GICS Sector*	*2017 Revenue ($mil)*	*Int. Income (1)*	*2013 IR?*	*Reporting Models Cited*	*External Assurance*	*SI in 10-K or AR (2)*	*SI in Proxy Statement (3)*	*Board Comm. on SI (4)*
General Electric	Industrials	$120,468	53%		GRI		10-K	Yes	Yes
Intel	Information Technology	$ 62,761	83%		GRI, IIRC & CDP	Partial	10-K	Yes	Yes
Pfizer	Health Care	$ 52,546	50%	Yes	GRI, SASB, IIRC & SDGs		AR		Yes
Allstate	Financials	$ 38,524	3%		GRI, SASB & SDGs		AR	Yes	
Medtronic	Health Care	$ 29,710	40%		GRI, SASB & CDP			Yes	
Eli Lilly & Co	Health Care	$ 22,871	44%		CDP & UNGC	Partial			
Southwest Airlines	Industrials	$ 21,171	0%	Yes	GRI & CDP		10-K		Yes
American Electric Power	Utilities	$ 15,425	0%	Yes	GRI, CDP & EEI			Partial	Yes
Ingersoll-Rand	Industrials	$ 14,198	35%	Yes	GRI	Yes	AR		Yes
Praxair	Materials	$ 11,437	47%		GRI, SASB, IIRC, SDGs, CDP	Partial		Yes	Yes
Entergy	Utilities	$ 11,074	0%		GRI & EEI	Partial	10-K	Yes	Yes
Clorox	Consumer Staples	$ 5,973	17%	Yes	GRI & UNGC	Yes	10-K	Yes	Yes
NiSource	Utilities	$ 4,875	0%		GRI & EEI	Partial	10-K		Yes
Dentsply Sirona	Health Care	$ 3,993	65%		CDP		10-K		

1. Share of 2017 revenues derived from markets outside the U.S. or North America, whichever figure was available.
2. Voluntary sustainability information included in Forms 10-K or annual reports.
3. Voluntary sustainability information included in the proxy statement, outside executive compensation and board governance.
4. Formal governance of sustainability issues through a board committee.

- **Half of the group obtained some form of external assurance for sustainability data.** Two out of the 14 integrated reporters obtained "full" external assurance for their sustainability information, a much higher rate (14 percent) than sustainability reporters overall (3 percent). Five additional companies obtained "partial" external assurance (35 percent).
- **Integrated reporters noted varying degrees of influence from existing sustainability reporting models.** Most cited was the GRI, with 12 companies mentioning it; seven companies referenced CDP and three provided an SDG information index.
    - References to integrated reporting frameworks were limited; four cited SASB and three cited IIRC, and just two—**Pfizer** and **Praxair**—cited both SASB and IIRC.

Pursuing "Shared Value for All"

Even though only three companies formally reference IIRC, its influence may be greater since most integrated reporters address IIRC's core concept of "creating shared value for all." Most of the integrated reports (11 of the 14) use this concept in their integrated reports, saying in some way that companies should create value for all stakeholders.

- References from companies to the idea of shared value for all are idiosyncratic. Seven are in a CEO/Chair letter, one in a Chief Sustainability Officer letter, two in the report body and one in an executive summary. *(Example statements, box on previous page.)*
- **This new approach to business expands significantly from a singular focus on the short-term bottom line.** This shift seems to reflect pressures that public companies now face to be

Quotes on Shared Value Creation from Integrated Reporters

- "Linking our strategy and business opportunities to important global trends creates long-term value for our people, customers and the world. Whether the challenge is climate change, urbanization or natural resources constraints, our expertise enables us to reduce energy demand and improve efficiency." — **Ingersoll Rand** (Page 8, *2017 Sustainability Supplement*)
- "At Dentsply Sirona, we believe that being a responsible corporate citizen creates value for all of our stakeholders, including our shareholders. For the first time, we have decided to integrate our financial and sustainability reporting to increase awareness and transparency about our corporate social responsibility platform." — **Dentsply Sirona** (Chairman's letter, *2017 Annual Report & Corporate Social Responsibility Platform*)
- "To continue creating prosperity businesses must take on a bigger role in society. Let's be clear, a business needs to make an acceptable profit since this is a measure of how effectively it uses society's resources. Yet more is expected and needed from business. Eighty-seven percent of young Americans believe that businesses need to do more than make a profit. Companies also need to be held accountable for creating jobs, making sure free markets work and improving our communities." — **Allstate** (Chairman's Letter, *2017 Prosperity Report*)
- "Our commitment to corporate responsibility and sustainability—built on a strong foundation of transparency, governance, and ethics—creates value for Intel and our stockholders by helping us mitigate risks, reduce costs, build brand value, and identify new market opportunities. We set ambitious goals for our company and make strategic investments to advance progress in the areas of environmental sustainability, supply chain responsibility, diversity and inclusion, and social impact that benefit the environment and society." — **Intel** (Page 5, *2017-18 Corporate Responsibility at Intel*)

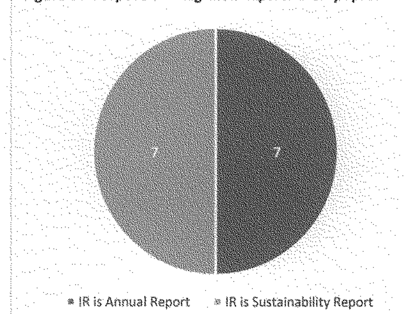
responsible citizens and even leaders of society, if they want to build long-term sustainable businesses. This is one of the major trends that is driving integrated reporting, as discussed in the background section of this report. *(See p. 10.)*

Courting Investors

Integrated reporters are more likely to treat sustainability information as material to investment decisions, making it easier for them to include these issues in normal business review processes. Where and how the companies position their integrated reports shows how this works:

- All 14 companies present their integrated reports in the ***investor relations section*** of their websites.
- **Seven (half) the companies offer integrated reports *as their annual reports*,** available under the annual information section of the companies' investor relations websites, alongside 10-Ks.[21]
- **Three companies offer integrated reports *in addition to and separate from* annual reports.** In all these cases, the integrated report serves primarily as the sustainability report with added data on financial dimensions, while the companies also offer separate annual reports. Two of these reports are provided under the annual information section of the investor relations website; the other, **Intel,** is not but its annual report also offers a section on sustainability issues.
- For the remaining four companies, the integrated report *serves as a **sustainability report*** but they do not offer separate annual reports and only issue a 10-K.
- **When it came to SEC filings, only a few companies treat sustainability matters as equal to financial ones.** Just **Intel** and **Clorox** included sustainability issues under business and/or strategy descriptions in their 10-Ks. Another two—**GE** and **Southwest Airlines**—made brief references to sustainability efforts in 10-Ks and provided links to sustainability data.

Figure 14: Purpose of Integrated Reports Evenly Split



- Notably, Southwest Airlines' mention of sustainability programs in its 10-K also includes a disclaimer: "Information contained in the Southwest One Report is not incorporated by reference into, and does not constitute a part of, this Form 10-K."
- These findings may suggest companies' reluctance to include information outside traditional financial reporting as part of their regulatory filings, although it may be just too early to draw any conclusion at all. For example, **Digital Realty Trust,** does not issue a separate sustainability report but includes key environmental performance metrics following the

[21] Si2 classified annual reports as stand-alone documents prepared by the company separate from Form 10-Ks filed with the SEC, although some companies offer as their annual report the 10-K with just a few additions tacked on the front, such as a CEO/chair letter.

SASB model in its 10-K, a very different approach from Southwest Airlines. *(See p. 14 for one company official's comments about liability concerns.)*

- The total number of companies in the integrated reporting group that have either included sustainability information in their 10-Ks or annual reports (71 percent) is much higher than that for general sustainability reporters (46 percent) or the S&P 500 (39 percent). *(See page 31 for more on all sustainability reporters.)*

Links to Formal Board Oversight of Sustainability

- Ten of the 14 integrated reporters (71 percent) disclose that they have a formal board committee overseeing sustainability issues, compared with 54 percent among the general pool of sustainability reporters and 42 percent of the overall S&P 500, according to proxy statement information identifying a board committee whose charter indicates it oversees either environmental and/or social issues.
- Eight of the 14 integrated reporters (57 percent) highlight sustainability efforts in their proxy statements above and beyond discussion of board committee oversight and executive compensation, compared with 44 percent of the general pool of sustainability reporters and 38 percent of the S&P 500.

III. Appendix

The study's list of indicators appears first, followed by assurance statements used by companies that provide full or partial assurance of their reports. A tally of how often companies use which assurance providers forms the third section of the appendix.

1. List of Indicators

	#	Indicator	Response	Explanation
General Sustainability Reporting	1	Company offers sustainability info on website	Yes/No/Partial	There is a designated webpage for sustainability or CSR information.
	2	Company offers a downloadable sustainability report	Yes/No/Partial	
	3	Company offers only web-based sustainability report	Yes/No	
	4	The sustainability report is time-bound	Yes/No	
	5	Frequency of report	Annual/biannual/ other	
	6	Past reports are available	Yes/No	At least one issue of previous report is archived and available.
	7	Report contains environmental performance metrics	Yes/No/Partial	The report offered multiple metrics to provide a minimal level of insight into the company's practices.
	8	Report contains environmental performance goals	Yes/No/Partial	Time-bound and quantified goals were disclosed.
	9	Disclosed GHG emissions data	Yes/No/Partial	GHG emissions data was disclosed in absolute numbers; GHG emissions intensity disclosures were tagged as "Partial."
	10	Disclosed time-bound GHG emissions reduction goals	Yes/No/Partial	Time-bound GHG emissions reduction goal was disclosed; GHG emissions intensity goals were tagged as "Partial."
	11	Disclosed social performance metrics	Yes/No/Partial	The report offered multiple metrics to provide a minimal level of insight into the company's practices.
	12	Report contains social performance goals	Yes/No/Partial	Time-bound and quantified goals were disclosed.
	13	Report indicated third-party assurance	Yes/No/Partial	Assurance of entire report or data set received "Yes"; assurance of selected data received "Partial."
	14	Assurance provider?		
	15	Report contained results of materiality analysis	Yes/No/Partial	
	16	Report described stakeholder engagement process	Yes/No/Partial	
	17	Report maps company goals aligned with SDGs	Yes/No/Partial	

	#	Indicator	Response	Explanation
Integrated Reporting	18	The company issues an integrated report	Yes/No	Counted declared and undeclared but integrated reports.
	19	Report follows or references the GRI	Follow/Reference/No	A full GRI report received "Follow"; own-style report with GRI Index received "Reference." GRI indexes varied widely in information and complexity.
	20	Report follows or references SASB	Follow/Reference/No	
	21	Report follows or references IIRC	Follow/Reference/No	
	22	Report follows or references SDGs	Follow/Reference/No	Companies offering SDGs related disclosure as part of its information index received "Reference."
	23	Report follows or references CDP	Reference/No	References to the CDP within main sustainability report was counted.
	24	Does it follow another? If so, what?		Other models used by companies included EEI, GRESB, IPIECA, TCFD and UNGC.
	25	Sustainability report includes a financial summary	Yes/No/Partial	
	26	Offers a third doc as an integrated summary	Yes/No/Partial	A shorter document separate from sustainability and annual reports references both.
	27	Percentage of 2017 revenues from outside US or North America		
IR in Financial Documents	28	Company's Form 10-K or annual report includes voluntary sustainability information	10-K/AR/No	
	29	Information in the 10-K or AR contains environmental and/or social information	E/ES/NA	
	30	Company's proxy statement contains voluntary information on sustainability issues	Yes/No/Partial	Counted voluntary highlight or summary of sustainability practices, outside of board governance and executive compensation descriptions
	31	Company's board had a committee of sustainability management	Yes/No/Partial	
	32	Board oversight of sustainability included environmental and/or social issues	E/ES/NA	

2. Companies that Provided "Full" External Assurance of Sustainability Reports

Company	Provider	Assurance Language
Apple	Bureau Veritas & Fraunhofer IZM	Assurance Letters, 2018 Environmental Responsibility Report: *Bureau Veritas North America, Inc. (BVNA) was engaged by Apple, Inc. (Apple) to conduct an independent assurance of select environmental data reported in its 2017 environmental report (the Report). This Assurance Statement applies to the related information included within the scope of work described below. ...* *The overall aim of this process is to provide assurance to Apple's stakeholders on the accuracy, reliability and objectivity of select information included in the Report.* *This information and its presentation in the Report are the sole responsibility of the management of Apple. BVNA was not involved in the collection of the information or the drafting of the Report.* *Fraunhofer IZM reviewed Apple's scope 3 carbon footprint data related to the products manufactured and sold by Apple Inc. in fiscal year 2017. ...* *This review checks transparency of data and calculations, appropriateness of supporting product related data and assumptions, and overall plausibility of the calculated* *comprehensive annual carbon footprint comprised of emissions derived from the life cycle assessment (LCA) of Apple products shipped in fiscal year 2017.* *Bureau Veritas North America, Inc. (BVNA) was engaged by Apple, Inc. (Apple) to conduct an independent assurance of its Supplier Clean Energy Program data reported in its 2017 environmental report (the Report). This Assurance Statement applies to the related information included within the scope of work described below.* *Fraunhofer IZM reviewed Apple's comprehensive fiber footprint data related to corporate fiber usage from products, corporate, and retail operations in fiscal year 2017.* *Fraunhofer IZM reviewed Apple's packaging plastic footprint data related to packaging plastic usage from products and retail operations in fiscal year 2017.*
Clorox	Ernst & Young (EY)	Clorox 2018 Integrated Report: *VOLUNTARY ASSURANCE OF NONFINANCIAL INFORMATION* *We believe voluntary assurance strengthens our reporting process and enhances the credibility of our nonfinancial information. We engage a third party to review the following nonfinancial key performance indicators: U.S. greenhouse gas emissions, U.S. energy*

Company	Provider	Assurance Language
		consumption, global water consumption, product sustainability improvements, workforce demographics, recordable incident rate, employee engagement and U.S. product donations. Items undergoing assurance are indicated throughout the report. We continue to look for opportunities to provide external review of metrics that provide further insight into how we create value for all our stakeholders.
Cummins	Bureau Veritas	Cummins 2017 GRI Databook: *Cummins' financial data is audited by PricewaterhouseCoopers LLP.* *The environmental, corporate responsibility, diversity, safety and governance data has been assured by Bureau Veritas. Bureau Veritas' assurance letters are included at the end of this report.*
Ingersoll-Rand	ERM Certification and Verification Services (ERM CVS)	Ingersoll-Rand 2017 Sustainability Report: *Our EHS data is assured annually by a third party and the results of our 2017 assurance can be found here.* Assurance Letter: *Lloyd's Register Quality Assurance, Inc. (LRQA) was commissioned by Ingersoll Rand Company (Ingersoll Rand) to assure the greenhouse gas (GHG) Emissions Inventory and other EHS Data for the calendar year 2017 (hereafter referred to as "the Assertion").* *The Assertion relates to direct GHG emissions (Scope 1), energy indirect GHG emissions (Scope 2), and Environmental, Health, and Safety (EHS) data. The EHS Data includes Energy Use, Water Use, Waste Data, Total Lost Time Incident Rate, Total Recordable Incident Rate, Number of Fatalities, and Occupational Illness Frequency Rate.*
Kimberly-Clark	WSP	Kimberly-Clark 2017 Sustainability Report, Assurance Statement: *WSP was commissioned by Kimberly-Clark Corporation (Kimberly-Clark) to conduct independent assurance of its 2017 Sustainability Report ('the report') as published on the company's website at https://www.sustainability2022.com/.* *We planned and performed our work in accordance with the AA1000 Assurance standard 2008 (AA1000AS). We were engaged to provide an AA 1000 Type 2 assurance, which covers evaluation of adherence to the AA1000 AS assurance principles of Inclusivity, Materiality and Responsiveness. We also reviewed the reliability of specified sustainability performance information to a moderate level of assurance. In addition, as criteria for our assurance work, we used the GRI 101 Foundation guidelines which set out the Reporting Principles for defining report content and quality and the ISO standard 14064-3: Greenhouse gases Part 3: Specification with Guidance for the validation and verification of greenhouse gas assertions. The information and presentation of data within the Sustainability Report is the responsibility of Kimberly-Clark. This statement is the responsibility of WSP and represents our independent*

Company	Provider	Assurance Language
		opinion. The intended users of this statement are the readers of the Kimberly-Clark Sustainability Report and it is intended for this statement to be read in its entirety.
Lockheed Martin	DNV GL	Lockheed Martin 2017 Sustainability Report: *Assurance: DNV GL, an independent third party, assured this report, including the Lockheed Martin Sustainability Management Plan performance indicators and select GRI indicators. Verification details are in the assurance statement.*
Newmont Mining	Bureau Veritas	2017 Sustainability Report: *Newmont does not have a formal written policy requiring external assurance for this report; however, in support of our commitment to ICMM's 10 Principles for Sustainable Development we engaged* *Bureau Veritas to independently assure our 2017 Beyond the Mine sustainability report.*
Prologis	Lloyd's Register Quality Assurance (LRQA)	2017 Sustainability Report: *This report has been externally assured by Lloyd's Register Quality Assurance (LRQA) using the AA1000 Assurance Standard (2008). LRQA interviewed members of the Prologis executive committee and senior management to ensure that this report complies with the principles of inclusivity, materiality and responsiveness.* *LRQA also assessed the reliability of specified sustainability performance information and verified our 2017 GHG inventory using the World Resource Institute and World Business Council on Sustainable Development Greenhouse Gas Protocol. Our complete External Assurance Statement is found on page 42.*
UPS	Deloitte & Touche	2017 GRI Index: *For this Report, we engaged Deloitte & Touche LLP to conduct a review, in accordance with attestation standards established by the American Institute of Certified Public Accountants, to provide a limited level of assurance on our 2017 Corporate Sustainability Report.* *We also engaged Deloitte & Touche LLP to conduct an examination, in accordance with attestation standards established by the American Institute of Certified Public Accountants, to provide a reasonable level of assurance on our Statement of Greenhouse Gas Emissions for the year ended December 31, 2017.* Assurance Statements: *We have examined the accompanying Statement of Greenhouse Gas Emissions ("Statement of GHG Emissions") of United Parcel Service, Inc. (the "Company") for the year ended December 31, 2017 for Scope 1, Scope 2, and Scope 3 greenhouse gas (GHG) emissions.*

Company	Provider	Assurance Language
		And *We have reviewed the accompanying 2017 Corporate Sustainability Report of United Parcel Service, Inc. (the "Company") for the year ended December 31, 2017. The Company's management is responsible for preparing and presenting the Corporate Sustainability Report in accordance with the Global Reporting Initiative Sustainability Reporting Standards under its Comprehensive option. Our responsibility is to express a conclusion on the Corporate Sustainability Report based on our review.*

3. External Auditors Most Frequently Used by S&P 500 Sustainability Reporters

Auditor	Number of Companies
Bureau Veritas	28
ERM-Certification and Verification Services (CVS)	16
Lloyd's Register Quality Assurance	19
Undisclosed	17
Cventure	8
WSP	9
EY	8
Deloitte & Touche	5
PricewaterhouseCoopers (PwC)	5
Trucost	5

Harvard Law School Forum on
Corporate Governance and Financial Regulation

Accuracy in Proxy Monitoring

Posted by Kobi Kastiel, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Monday, September 16, 2013

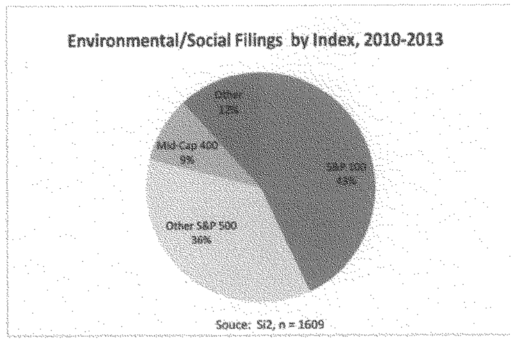
Tags: **Board monitoring**, **Corporate Social Responsibility**, **Political spending**, **Proxy season**, **Proxy voting**, **Shareholder activism**, **Si2**, **Sustainability**
More from: **Heidi Welsh**

Editor's Note: The following post comes to us from **Heidi Welsh**, Executive Director at the **Sustainable Investments Institute** (Si2), and is based on a Si2 report. This post relates to reports by Proxy Monitor, the most recent of which was discussed on the Forum **here**.

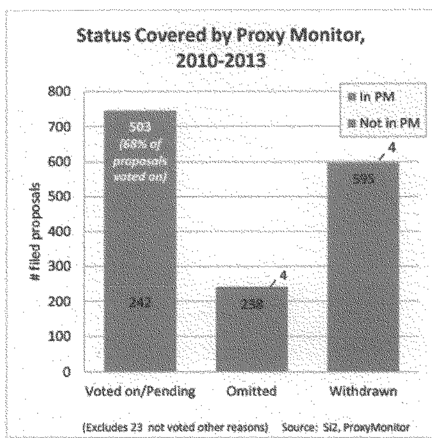
Shareholder activists are meeting now to consider what proposals they will file for the 2014 proxy season and the results are largely in from the 2013 proxy season, with analysis coming from all the different proponent groups, the proxy advisory firms and others interested in what happened this year. Si2's own report in August showed that the upward climb of investor support for social and environmental policy proposals continued this year, with average support hitting a record level of 21.3 percent and requests for more board and workplace diversity, sustainability reporting and corporate political activity disclosure got the highest levels of support. (More information on these overall findings and overall trends, illustrated with charts, appears **here**.)

One group that reports on proxy season findings is Proxy Monitor, a project of the Manhattan Institute's Center for Legal Studies. It focuses on resolutions that go to votes at the 250 largest U.S. firms, reporting on the vote results and presenting analysis of the trends on its **website**. The group's analyses of proxy season results trends have some significant blind spots that are not always apparent to the novice proxy analyst, but its reports nonetheless are widely quoted in the press. As such, they deserve some scrutiny, which this post offers. Si2 took a look at all the shareholder resolutions filed since 2010 and compared the results to the Proxy Monitor database to see precisely how PM reaches its conclusions.

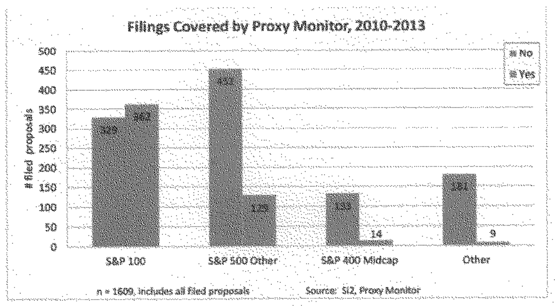
Proxy Monitor's big company bias: A core problem with the Proxy Monitor analysis is its focus only on the largest companies. It is true that activists file the bulk of their proposals at S&P500 companies, which provide more bang for the buck in terms of potential press exposure, influence on corporate policy (given a common follow-the-leader approach) and potential impact on the amount of business (if Wal-Mart changes its supply chain, there are 60,000-plus firms affected). Increasingly, though, relatively smaller companies outside the elite tier must answer to pointed questions about how they handle a wide range of sustainability issues. About 80 percent of the 1,609 proposals filed since 2010 were at S&P 500 companies, with 43 percent of the total at the 100 largest-earning companies. But 9 percent went to Mid-Cap 400 firms and 12 percent went to firms in other indices.



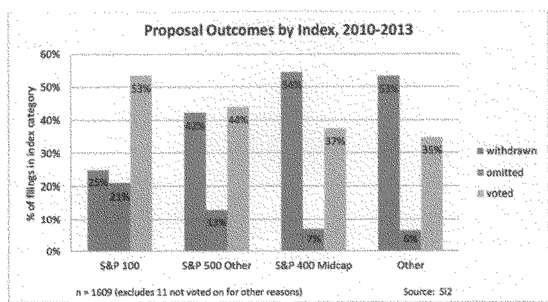
Withdrawn and omitted proposals missed: Aside from its big-company bias, which means only 68 percent of the social/environmental votes between 2010 and 2013 have been tabulated by Proxy Monitor, its conclusions are skewed in anther critical way. They largely miss filed proposals withdrawn or omitted after company challenge under provisions of the shareholder proposal rule. Since many active investors see corporate engagement through the shareholder resolution process as a key objective in itself, as an exercise of their responsibility as owners of companies, and because withdrawals usually occur after companies agree to more disclosure or some other element forwarded by the proposed resolution, the Proxy Monitor results understate the total impact of shareholder activism.



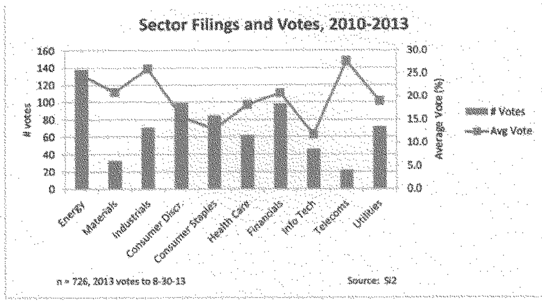
Disaggregating results by index shows further the extent to which the Proxy Monitor database and related reports miss out on describing corporate engagement that occurs during the corporate annual meeting season, illustrated below.



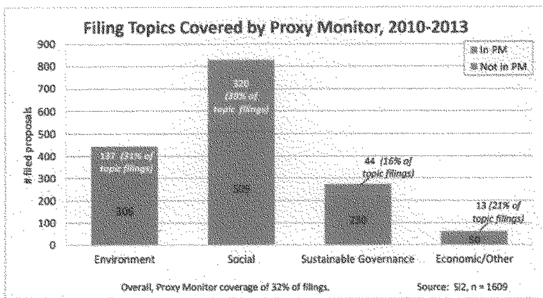
Resolutions filed at the largest companies are more likely to be voted on than proposals filed at other companies, with 53 percent of filed proposals going to votes at the S&P 100 compared with only 37 percent at Mid-Cap 400 companies. Proposals filed at relatively smaller companies also are more likely to be withdrawn, usually after negotiations between management and proponents that produce agreements. (More research into why that occurs is warranted.) The largest companies also are more likely to successfully challenge resolutions under provisions of the shareholder proposal rule and to receive SEC approval for excluding them from proxy statements, with 21 percent of filings at S&P 100 companies omitted compared with just 7 percent at Mid-Cap 400 companies. This is likely the result of well-financed and experienced legal teams.



Energy sector firms get the most proposals that go to votes: Resolution volume and average votes in favor of proposals on social and environmental topics vary by sector. Since 2010, Energy sector companies have received the most proposals that have gone to votes—nearly 140 resolutions, and these have earned support from about one-quarter of the votes cast for and against. Other sectors that have received a relatively high number of proposals have been Consumer Discretionary, Consumer Staples and Financials firms, with companies in these sectors seeing 80 to 100 resolutions go to votes in the last four years combined. Consumer Discretionary, Consumer Staples and Information Technology sector firms saw votes average about 15 percent or less, but all the other sector vote averages were close to or above 20 percent, taking all the issues together. (A more detailed analysis of votes by sector and issues is beyond the scope of this brief post.)



Topic areas most commonly missed: The Proxy Monitor coverage of the topics raised in shareholder resolutions filed on social and environmental issues is the most complete for social policy matters (including most prominently corporate political activity, decent work, human rights and workplace diversity) and the most limited for sustainable governance topics (such as sustainability reporting, board diversity and board oversight). Even so, Proxy Monitor misses 60 percent of the filings on social issues. Its coverage of environmental topics misses 70 percent of the filings and for sustainable governance nearly 85 percent of the activity. Investors file far fewer proposals on economic justice issues (mostly relating to fair lending) and many of these have not gone to votes; Proxy Monitor misses 80 percent of these filings.



Vote results are inconsistent: When it comes to reporting on the results, Proxy Monitor does not use a consistent methodology, making apples-to-apples comparisons of voting results impossible. Long-time observers of shareholder resolution results use the standard set out in the SEC's shareholder proposal rule that governs resubmission thresholds, counting the shares cast in favor divided by those cast for and against (3 percent for first-year proposals, 6 percent for second-year proposals and 10 percent for third-year and subsequent proposals). Companies do not always use this standard when reporting on voting results, however. They variously include in their calculations shares cast as abstentions or votes outstanding. Proxy Monitor appears to base its reporting not on the votes cast but instead on the percentage reported by the company. A consistent calculation can be discerned by examining corporate 8-K filings, however, gleaning comparable results.

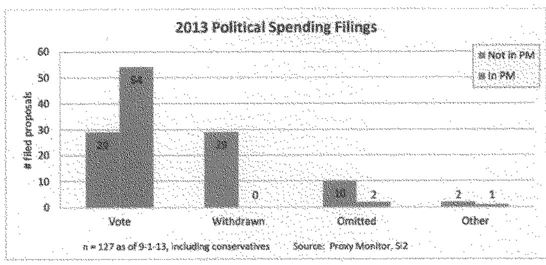
In the last four years, the Proxy Monitor results reported therefore have consistently understated the voting results, sometimes significantly. The table below shows the largest gaps, in which resolutions that earned more than 40 percent of the total shares cast (and in two cases majority votes, at Sprint Nextel and Tesoro) were reported to have earned far less in the Proxy Monitor tally. These differential vote tallies were most common for corporate political spending resolutions: seven of the nine proposals that earned 40 percent or more of the shares cast in favor were on political activity. The two others were about refinery safety at Tesoro and Valero Energy.

High Shareholder Votes and Proxy Monitor Results Reported, 2010-2013					
Year	**Company**	**Proposal**	**Vote For (% of yes+no)**	**Proxy Monitor %**	**Difference**
2011	Tesoro	Report on accident prevention efforts	54.3	34.3	20.0
2010	Coventry Health Care	Review/report on political spending	46.0	30.3	15.7
2012	Coventry Health Care	Review/report on political spending	48.6	34.0	14.6
2011	Coventry Health Care	Review/report on political spending	44.3	30.2	14.1
2011	Sprint Nextel	Review/report on political spending	53.4	41.0	12.4
2011	Halliburton	Review/report on political spending	46.5	34.4	12.1
2013	McKesson	Review/report on political spending	46.8	35.3	11.4
2011	Valero Energy	Report on accident prevention efforts	43.3	33.4	9.9
2010	Sprint Nextel	Review/report on political spending	41.2	31.4	9.8

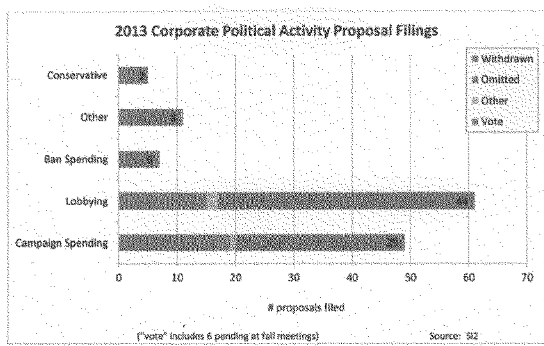
2013 Proxy Season Results

As the analysis above clearly shows, the Proxy Monitor database has significant limitations and does not present a comprehensive picture of corporate engagement by investors. It also does not consistently present comparable vote results. As a result, the conclusions reached from the data are both limited and inaccurate. With respect to the 2013 proxy season, Proxy Monitor **concluded** that companies faced more shareholder proposals than in 2012 but said average support fell and no social policy proposal earned a majority vote. Proxy Monitor also reported in early summer that corporate political spending proposals were the most common type of resolution, none received majority support and their average support was 18 percent. The picture of what really happened is quite different, as the discussion below clearly shows.

Corporate political activity: The chart below shows which of all the corporate political activity shareholder resolutions filed in 2013 were covered by Proxy Monitor. Thirty-four of the 83 votes to date, all 29 of the withdrawals and 10 of the 12 omissions were excluded.



In 2013, there were more proposals on corporate political activity that dealt with lobbying than with campaign spending, as Proxy Monitor indicates. Proponents of these resolutions also withdrew a relatively smaller proportion of the lobbying resolutions compared with the campaign spending proposals, which used the template of the Center for Political Accountability.



A close look at the 83 resolutions that have gone to votes as of September 1 illustrates the extent to which Proxy Monitor understates the level of investor support for more disclosure on corporate activity—be it for campaign spending or lobbying. Campaign spending and oversight proposals have gotten the highest level of average support overall in 2013, with 31.5 percent, but they were closely followed by resolutions asking for more complete disclosure of lobbying expenditures (which got 27.1 percent on average). Both emphasize spending through intermediaries such as trade associations and non-profit groups that need not report their donors, so-called "dark money." Investor support is very limited for other types of proposals about corporate political activity—such as banning spending or those from conservative groups questioning corporate support for gay rights or health care reform. (The two majority votes noted below occurred at firms not tracked by Proxy Monitor—Mid-Cap constituent Alliant Techsystems and CF Industries, which is in the S&P 500 but outside the top 250 firms PM tracks—at meetings in late July that occurred after the group published its analysis of the season.)

2013 Corporate Political Spending Shareholder Resolution Votes						
	All Filed Proposals			*Proxy Monitor*		
Proposal Type	**# votes**	**Avg %**	**Highest %**	**# votes**	**Avg %**	**Highest %**
Campaign Spending	25	31.5	66.0	14	25.6	40.6
Lobbying	43	27.1	64.8	29	20.9	37.0
Ban Spending	6	4.4	6.2	5	4.6	5.7
Other	7	4.7	6.4	4	4.7	6.4
Conservative	2	3.9	4.2	2	3.9	4.2
Grand Total	**83**	**24.3**	**66.0**	**55**	**18.8**	**40.6**

Conclusion

This post shows the extent to which Proxy Monitor misses much of what happens in the U.S. proxy season. Shareholder proponents—generally a liberal crowd—can have a tendency to overstate the impact of their actions, but their focus on off-balance sheets risks has prompted growing support in the investment world and traction with companies that is irrefutable. Proxy Monitor hoists a flag for the contention that social policy shareholder activism can be discounted, for any number of reasons. But at the very least, this discussion about shareholder resolution outcomes should be grounded in fact, not based on a skewed subset of the results.

Both comments and trackbacks are currently closed.

AFL-CIO

AMERICA'S UNIONS

American Federation of Labor and Congress of Industrial Organizations

815 16th St., NW
Washington, DC 20006
202-637-5000
aflcio.org

November 9, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: SEC Staff Roundtable on the Proxy Process [File No. 4-725]

Dear Mr. Fields:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I welcome this opportunity to provide comment to the Securities and Exchange Commission (the "SEC") on the SEC Staff Roundtable on the Proxy Process, File No. 4-725. We are deeply concerned that the SEC's review of the proxy process appears to be in response to the demands of the Business Roundtable, U.S. Chamber of Commerce and National Association of Manufacturers, not the investor community. This letter describes our views on the issues that Chairman Jay Clayton has identified as potential topics for consideration by the SEC Staff Roundtable on the Proxy Process.

The AFL-CIO is the umbrella federation of U.S. labor unions, including 55 unions representing 12.5 million members. Union-sponsored and Taft-Hartley pension and employee benefit plans hold more than $667 billion in assets. Union members also participate directly in the capital markets as individual members and as participants in pension plans sponsored by corporate and public sector employers. Union members' pension and employee benefit plans routinely participate in the proxy process when exercising their fiduciary duty to vote proxies. Many of these plans also submit shareholder proposals as part of their shareholder engagement activities to promote long-term value creation.[1]

Voting Process

Proxy voting is the very foundation of the corporate governance system, and any changes to the voting process must protect shareholder democracy. Under the current proxy voting system, Broadridge Financial Solutions, Inc. ("Broadridge") processes and distributes proxy materials to beneficial owners who hold their securities through brokerages and banks in "street name." Broadridge also

---

[1] *See* Interpretive Bulletin 2016-01 and Field Assistance Bulletin 2018-01, Department of Labor.

tabulates these beneficial owners' voting instructions for their bank or broker. Any changes to this voting process must protect the rights of shareholders to communicate with each other on the same terms as corporate issuers. Moreover, shareholders' voting instructions and proxy votes should be tabulated fairly and confidentiality by an independent third party.

Retail Shareholder Participation

Retail shareholder participation fell dramatically after the SEC allowed corporate issuers to send retail shareholders a notice of internet availability of proxy materials ("Notice and Access"). For the 12 months ending June 30, 2017, only 21.7% percent of shares voted after receiving Notice and Access mailings compared to 40.9% of shares that received full packages of printed proxy materials.[2] Because many retail shareholders are unable or unwilling to obtain proxy materials electronically, the electronic dissemination of proxy materials should be "opt-in" rather than "opt-out." Moreover, the SEC's proxy disclosure rules can only work to inform shareholders if proxy statements and proxy cards are provided together by the same delivery means.

Shareholder Proposals

Shareholder proposals are an integral part of shareholder democracy in the United States. Over the past several decades, shareholder proposals have facilitated the private ordering of companies on a variety of environmental, social and governance issues. The SEC's shareholder proposal rule is a remarkably cost-effective mechanism to elevate shareholder concerns to boards of directors and corporate management. Given the low costs and extraordinary high benefits of this process, it is hard to imagine how any changes to the shareholder proposal rule could satisfy a comprehensive cost-benefit analysis. Increasing the stock ownership requirements or the vote resubmission requirements for shareholder proposals will effectively disenfranchise many shareholders from placing proposals on corporate ballots. Please see our attached comment letter dated November 1, 2017 that explains that there is no evidence that any changes are needed.

Proxy Advisory Firms

The SEC should hold proxy advisory firms to the same standards as other registered investment advisors who owe a duty of loyalty to their clients, not to the managers of the companies that they invest. Corporate issuers do not pre-review stock analyst reports that recommend whether to buy or sell securities. Why should proxy advisory firm reports be treated any differently? Allowing corporate issuers to pre-review proxy advisory firm reports before publication will create the opportunity to delay and interfere with unfavorable vote recommendations. Moreover, institutional investors do not blindly follow proxy advisory firm recommendations as "robo-voters." In reality, the clients of proxy advisory firms use this research as a supplement to their own proxy voting process. For these reasons, we oppose the creation of a special regulatory regime for proxy advisory firms that differs from other registered investment advisors.

---

[2] *Analysis of Distribution and Voting Trends Fiscal Year Ending June 30, 2017*, Broadridge Financial Solutions, Inc. (2008), *available at* https://www.broadridge.com/white-paper/broadridge-analysis-of-traditional-and-notice-access-issuers-na-adoption-distribution-and-voting.

Technology and Innovation

The SEC should closely monitor the growing use of "virtual" shareholder meetings. Shareholder meetings are the corporate equivalent of the town hall meeting, a vital part of the democratic process. Retail shareholders including employee-owners are the primary attendees at shareholder meetings. For these investors, the shareholder meeting is the one day of the year that they may ask a question of their company's CEO and board of directors. We are concerned that the technology of "virtual" shareholder meetings may be abused to unreasonably screen shareholders' questions and silence dissenting views. For this reason, the use of virtual technology should supplement physical shareholder meetings, but not serve as a replacement.

Other Commission Action

We support amending the SEC's proxy rules to require the use of universal proxy cards to include the names of all nominees in contested board of director elections. Just as is currently practiced in our electoral democracy, shareholders should have the flexibility to vote for the director nominees of their choice. However, the current proxy process compels shareholders who are voting by proxy to choose between two competing slates of candidates. Shareholders who wish to vote a "split ticket" for directors on both slates of candidates cannot do so if they do not physically attend the shareholder meeting. For this reason, the SEC should adopt its 2016 proposed rule to require the use of universal proxy cards showing all director nominees.

Conclusion

Any changes to the proxy process must be guided by the need to protect shareholder democracy. For this reason, we strongly oppose the SEC undertaking any rulemaking will reduce shareholders' rights to participate in the proxy process. We believe that the SEC should better use its limited resources on higher priorities than engaging in unnecessary rulemakings that the investor community has not requested. Thank you for considering the AFL-CIO's views on the proxy process. If we can provide you with additional information, please contact Brandon Rees, Deputy Director of Corporations and Capital Markets, at (202) 637-5152 or brees@aflcio.org.

Sincerely,

Damon A. Silvers
Director of Policy & Special Counsel

Enclosure

AFL-CIO

AMERICA'S UNIONS

American Federation of Labor and Congress of Industrial Organizations
815 16th St., NW
Washington, DC 20006
202-637-5000
aflcio.org

November 1, 2017

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Request for rulemaking to amend Rule 14a-8 under the Securities Exchange Act of 1934 regarding resubmission of Shareholder Proposals [File No. 4-675]

Dear Mr. Fields:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to express our strong opposition to the petition submitted by the U.S. Chamber of Commerce requesting that the Securities and Exchange Commission (the "SEC") amend Rule 14a-8 under the Securities Exchange Act of 1934 regarding resubmission of Shareholder Proposals (the "Petition"). For the reasons set forth below, a rulemaking to modify Rule 14a-8 is a counterproductive use of the SEC's limited resources.

The AFL-CIO is the umbrella federation of U.S. labor unions, including 56 unions representing 12.5 million members. Union-sponsored and Taft-Hartley pension and employee benefit plans hold more than $667 billion in assets. Union members also participate directly in the capital markets as individual members and as participants in pension plans sponsored by corporate and public-sector employers. Altogether, U.S. workers' pension plans hold over $7 trillion in assets. Union members' pension plans routinely vote on shareholder proposals and many of these pension plans are active proponents of shareholder proposals.

The SEC's Rule 14a-8 on shareholder proposals facilitates the private ordering of public companies on a variety of corporate governance issues. The U.S. Chamber of Commerce and the Business Roundtable endorsed this use of the shareholder proposal process in its petition for review of the SEC's proxy access rule by writing that "shareholder choice is entirely appropriate for rules intended to further state law principles of corporate governance, the foundation of which is self-government and private ordering."[1] It is ironic that these same business groups now seek to limit shareholders' ability to achieve a private ordering under Rule 14a-8.

Shareholder proposals on proxy access show how Rule 14a-8 facilitates the private ordering process. Since the SEC's proxy access rule was vacated in 2011, shareholders have submitted 309 proposals at S&P 500 companies urging the voluntary adoption of proxy access bylaws.[2] Half of these proposals did not go to a vote as companies agreed to adopt their own proxy access bylaws.[3] Proxy access proposals that went to a vote routinely received majority support except in cases of controlled companies.[4] Today, more than 60 percent of S&P 500 companies have adopted proxy access, and this percentage is expected to exceed 75 or 80 percent by 2018.[5]

Over the years, shareholders' ability to submit proposals under Rule 14a-8 has resulted in dramatic changes in the corporate governance of public companies. However, it may take many years for consensus to emerge in the marketplace. For example, shareholder support for proposals urging annual director elections took decades to reach majority vote status.[6] Twenty years ago, more than 60 percent of S&P 500 companies maintained a classified board structure. Today, less than 20 percent of S&P 500 companies have classified boards in large part due to the successful submission of shareholder proposals urging annual director elections.[7]

The private ordering successes of shareholder proposals are not limited to corporate governance issues. In recent years, environmental and social concerns have become an increased focus area for shareholder proposals. This reflects a growing recognition in the capital markets that these issues are material to investors.[8] As requested by shareholder proposals, companies today

---

[1] Brief for Petitioners at 9, Business Roundtable and Chamber of Commerce of the United States of America v. U.S. Securities and Exchange Commission, 647 F.3d 1144 (D.C. Cir. 2011). Available at: https://www.uschamber.com/sites/default/files/legacy/files/1009uscc_sec.pdf.
[2] AFL-CIO analysis of Institutional Shareholder Services ("ISS") Voting Analytics database of shareholder proposals submitted between 2011 and 2017 requesting a proxy access bylaw amendment at S&P 500 companies.
[3] *Id.* The vast majority of proxy access proposals that did not go to a vote were either voluntarily withdrawn by the proponent or were omitted from the proxy under Rule 14a-8(i)(10) (substantial implementation).
[4] *Id.*
[5] Marc Gerber, "Proxy Access: Highlights of the 2017 Proxy Season," Skadden, Arps, Slate, Meagher & Flom LLP, July 1, 2017. Available at https://corpgov.law.harvard.edu/2017/07/01/proxy-access-highlights-of-the-2017-proxy-season/.
[6] Noam Noked, "Activism and the Move toward Annual Director Elections," Harvard Law School Forum on Corporate Governance and Financial Regulation, January 15, 2012. Available at https://corpgov.law.harvard.edu/2012/01/15/activism-and-the-move-toward-annual-director-elections/.
[7] Lucian Bebchuk et. al, "Towards the Declassification of S&P 500 Boards," Harvard Business Law Review, Vol. 3, No. 1, pp.157-184 (2013). Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2400652.
[8] For example, signatories to the U.N. Principles for Responsible Investment that have committed to incorporating ESG factors into their investment decisions now total $62 trillion in assets under management. "Responsible investment market update: a snapshot of signatory action," The Principles for Responsible Investment, March 20, 2017, https://www.unpri.org/news/pri-report-on-progress-signatories-more-committed-than-ever-to-responsible-investment.

routinely provide reporting on environmental sustainability and climate change risks. Social responsibility issues such as employment diversity, political spending disclosure, and respecting human rights are also routinely reported by companies as called for by shareholder proposals.

Over the years, the topics of many shareholder proposals have been incorporated into today's regulatory standards for publicly listed corporations. For example, the NYSE and NASDAQ listing standards now require majority independent boards of directors and entirely independent audit, compensation, and nominating committees – a reform first called for by shareholder proposals. Shareholder proposals also first called for the auditor independence requirements contained in the Sarbanes-Oxley Act, the "say-on-pay" vote requirements contained in the Dodd-Frank Act, and the expensing of stock options that is now mandated by U.S. GAAP.

The importance of shareholder proposals to the private ordering process is evident by the large number of proposals that shareholders withdraw after dialogue with companies. Less than half of all submitted proposals actually go to a shareholder vote. According to the ISS Voting Analytics database, 11,706 proposals were filed at Russell 3000 companies between 2004 and 2017. Only 5,342 of these shareholder proposals (46 percent) went to a shareholder vote. The SEC permitted companies to omit 1,741 proposals (15 percent). The remaining proposals (39 percent) were withdrawn by shareholders after a dialogue with the company or otherwise did not go to a vote.

The U.S. Chamber of Commerce petition does not provide any factual support for the claim that shareholder proposals have increased to unsustainable levels. To the contrary, the number of proposals has been remarkably consistent in recent years. According to the ISS Voting Analytics database, shareholders submitted an average of 836 proposals at 386 companies per year between 2004 and 2017. The number of submitted proposals fell to its lowest point in 2011, with 603 proposals submitted at 307 companies, and reached its highest level in 2015 with 967 proposal submissions at 478 companies. In 2017, shareholders submitted 841 proposals at 420 companies.

Voting on shareholder proposals is not burdensome to shareholders, and the incidental costs of including shareholder proposals in company proxy statements is immaterial. In fact, most public companies do not receive any shareholder proposals in a typical year. On average, only 13 percent of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS Voting Analytics database. In other words, the average Russell 3000 company can expect to receive a shareholder proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.

Nor is the shareholder proposal process taxing on corporate management or boards of directors. Corporate secretaries routinely handle all aspects of the shareholder proposal process, not CEOs or directors. The vast majority of shareholder proposals are submitted at large companies who have experienced and well-staffed corporate secretaries. According to the ISS Voting Analytics database, 77 percent of proposals that shareholders submitted in the first three quarters of 2017

U.S. Securities and Exchange Commission
November 1, 2017
Page Four

were filed at S&P 500 companies. Large companies are far more likely to receive shareholder proposals because these companies represent a greater portion of investors' equity portfolios.

The U.S. Chamber of Commerce petition falsely claims that the Rule 14a-8(i)(12) resubmission vote thresholds promote a "tyranny of the minority" because shareholders may resubmit proposals indefinitely if they receive more than 10 percent support after three years. This argument presumes that resubmitted proposals that did not receive a majority vote are undesirable for the private ordering process. To the contrary, the resubmission of proposals allows companies to receive annual shareholder feedback on emerging issues. Notably, the SEC itself considered and rejected increasing the resubmission vote thresholds in 1997.[9]

Other proposed changes contained in the Financial Choice Act of 2017 (H.R. 10) threaten to disenfranchise investors by dramatically increasing the Rule 14a-8(b) share ownership requirements. The SEC's shareholder proposal rule has always been available to small investors dating back to its origin in the 1940s. The SEC first adopted a $1,000 share ownership requirement in 1983, and then increased the threshold to $2,000 in 1998. If enacted, the Financial Choice Act will silence the ability of small investors to participate in the private ordering process. Significantly, proposals by individuals enjoy high levels of shareholder support.[10]

For these reasons, we strongly urge the SEC to refrain from undertaking a rulemaking to amend Rule 14a-8. The SEC's shareholder proposal rule has been a longstanding feature of the U.S. capital markets and has facilitated the private ordering of companies on a variety of issues. Like previous SEC rulemakings on Rule 14a-8, a proposed rulemaking will be a long and arduous process that will likely result in only minimal changes to Rule 14a-8. Investors will be better served by deploying the SEC's limited resources on other more pressing concerns.

Thank you for considering the AFL-CIO's views on Rule 14a-8. If we can provide you with additional information, please contact Brandon Rees at (202) 637-5152 or brees@aflcio.org.

Sincerely,

HSC

Heather Slavkin Corzo, Director
Office of Investment

HSC/sdw
Opeiu #2, afl-cio

[9] SEC, "Final Rule: Amendments to Rules on Shareholder Proposals," Release No. 34-40018 (May 21, 1998), available at https://www.sec.gov/rules/final/34-40018.htm.
[10] According to the ISS Voting Analytics database, proposals submitted by the Chevedden, Steiner and McRitchie families received, on average, the support of 40 percent of shareholders between 2004 and 2017.

Center for American Progress

1333 H Street, NW, 10th Floor
Washington, DC 20005
Tel: 202 682.1611 • Fax: 202 682.1867

www.americanprogress.org

December 4, 2018

The Honorable Michael Crapo, Chairman
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing and Urban Affairs
U.S. Senate
Washington, DC 20510
Via electronic submission

RE: "Proxy Process and Rules: Examining Current Practices and Potential Changes"

Dear Sirs:

The Center for American Progress is pleased to submit the following comment in advance of the committee's hearing on the proxy process and rules. We commend the committee for engaging in this important opportunity to hear from investors, market participants, scholars, and the public on the need to ensure transparency and accountability in our public markets.

Attached please find a report entitled "Corporate Long-termism, Transparency, and the Public Interest" (the "CAP Report") that we believe should inform any actions that policymakers take in this area, including both the legal policy and the economic analysis. The CAP Report points to the need for much greater need disclosure to support corporate long-termism, principally through greater provision of environmental, social and governance (ESG) information and the enhancement of the linkages between investors, boards and management regarding the use of that information. The report highlights how ESG information is central to the ability for corporate stakeholders to support the efficient allocation of capital in the economy and secure the long-term returns, including the minimization of risks, that flow from those decisions.

The proxy process continues to offer core channels for market forces to drive greater corporate long-termism. Private ordering under the shareholder proposal process, for example, has allowed investors to demand, and companies to respond with, greater long-termism oriented information and relevant substantive changes that follow. Indeed, in an era of unexpected and often systemically impactful risks, shareholder proposals are well-functioning risk management tools and investor-company communication safety values that should be welcomed rather than attacked. Moreover, with concentration, inequality, and questionable market practices increasingly leading to a market dominated by corporate royalty, policymakers should be on guard against efforts to lock out "Mr. and Mrs. 401(k)" and the broader public from the appropriate tools of corporate governance.

Hon. Michael Crapo, Chairman
Hon. Sherrod Brown, Ranking Member
December 4, 2018
Page Two

Similarly, investors should have access to the free flow of information that they demand, such as from proxy advisors. Other recommendations to improve the proxy process including asking asset managers to provide more information to their shareholders about how they approach ESG matters and long-term issues generally, with appropriate updates to voting and accountability rules. In addition, the CAP Report calls into question excessive reliance in recent rulemakings on making affirmative determinations regarding materiality to trigger disclosure requirements or otherwise undermining a strong approach to materiality.

We encourage the committee to consider the report in its entirety and would welcome the chance to discuss its ideas in greater detail. Should you, your colleagues or staff have any questions, please do not hesitate to contact us at (202) 682-1611.

Sincerely,

/Andrew J. Green/ /Andrew Schwartz/

Andy Green
Managing Director
Economic Policy

Andrew Schwartz
Policy Analyst
Economic Policy

Corporate Long-Termism, Transparency, and the Public Interest

By Andy Green and Andrew Schwartz October 2018

WWW.AMERICANPROGRESS.ORG

Center for American Progress

Corporate Long-Termism, Transparency, and the Public Interest

By Andy Green and Andrew Schwartz October 2018

Contents

Introduction and summary

America's capital markets—made up of the stock, bond, and related financial markets—enable millions of investors to allocate capital every day to what they hope are the best economic uses in the coming years. When those markets are fair, efficient, and competitive, those investments play a central role in contributing to a vibrant economy and society. Growing companies produce the goods and services that the public needs, workers obtain employment, and investors earn returns on their investments. But capital markets are far from self-regulating; when they are insufficiently transparent or accountable, significant problems arise. Investors can be defrauded; good companies and their workers can fail to obtain the capital they need; and the public can suffer from worsening inequality, environmental damage, financial crises, and more.

America has some of the most robust capital markets in the world, but significant weaknesses in the functioning of the private markets expose American investors and the public to risks, harms, and lost opportunities. Indeed, a good deal of evidence suggests that today's markets are too short-termist and fail to align the interests of corporate stakeholders to drive shared, long-term success.

An earlier Center of American Progress report—"Long-Termism or Lemons: The Role of Public Policy in Promoting Long-Term Investments"— explored how an excessive corporate focus on short-term results appears to be reducing business investments.[1] This trade-off likely means lower growth rates, reducing total output by 6 percent over a century.[2] The 2015 report offered a range of ideas to increase the long-term focus of the markets.

But "Long-Termism or Lemons" did not address the question of whether investors, markets, and key corporate stakeholders are sufficiently informed—and from that information, empowered—to do the basic work of the capital markets: drive smart capital decisions for the long term. This report asserts that the answer to that question is "no." Shareholders and stakeholders of all types and sizes do not have access to the long-term-oriented information they need—in particular, environmental, social, and governance (ESG) information—in a consistent, comparable, and reliable manner.[3]

Public oversight of the nation's stock markets is premised on the need for government to mandate corporate transparency. Corporations are understandably unwilling to voluntarily share information that might not be flattering but that investors and the public need to distinguish between good and bad investments. Moreover, information must be shared in a consistent, comparable, and reliable manner for it to be useful to investors and the public—and hence to enable efficient markets.

The Securities and Exchange Commission (SEC) was created during the Great Depression to address market failures and ensure this very transparency.[4] Over the years, as investors, the economy, and the public interest have evolved, the SEC has had to update its requirements. When it has failed to do so, the consequences to investors of all types and to the public interest have been severe.[5] Today, the SEC is behind the curve on mandating the disclosure of sufficient long-term-oriented information, especially ESG information. Its reliance to date on the private market to execute this public regulatory function has not worked.

The informational asymmetries created by these gaps in disclosure undermine the alignment of interests that the capital markets need to drive shared long-term success—what might be termed corporate long-termism. Investors lack the information needed to make smart front-end allocation of capital to long-term, socially beneficial uses. Management lacks the incentives needed to enable them to focus on the long term—whether that involves maximizing opportunities or minimizing risks. And the public, including policymakers, lacks the information needed to make intelligent long-term decisions about the economy and policy overall.

Unfortunately, the economic and societal consequences of this major roadblock to corporate long-termism are significant. Similarly, economies and societies are being roiled by popular dissatisfaction with globalization, rapid technological change, growing market concentration, and extraordinary levels of inequality.[6] Even as the stock market is driven forward on the back of massive tax cuts and buybacks, collapsing middle- and working-class wealth poses significant long-term economic risks.[7] Even more concretely, a study by *The Economist* found that by 2100, climate risks alone could imperil $4 trillion to $14 trillion in private sector assets and $43 trillion when public sector assets are included.[8]

Given the capital markets' propensity to fads, booms, and busts, the market failure to provide sufficient ESG information to investors and other key market participants and corporate stakeholders may represent one of the most underappreciated systemic vulnerabilities of the U.S. financial system—and hence to U.S. economic growth.[9] Furthermore, in an era where information and misinformation are often given equal footing in the public square, defending the quality of information in the capital markets is critical to protecting reliable economic growth.[10]

More long-term-oriented companies and capital markets cannot solve all the world's problems, but they can make a meaningful difference in a lot of areas. Companies both affect and are affected by a wide range of ESG issues: employee and board diversity; worker benefits and training; environmental risks; financial stability; human rights; corporate political influence; tax evasion; monopoly power; and more. Indeed, investors and the public have already said so: The SEC's 2016 Concept Release on Regulation S-K—the principal SEC regulation that governs corporate disclosure—garnered more than 26,500 comments from investors and the public. An analysis of these commenters showed that the comments overwhelmingly and persuasively favored ESG disclosures across a wide range of issues.[11]

That's in no small part because ESG matters are increasingly important to the long-term performance of companies themselves, especially their management of risk. And investors have been taking notice, in no small part because the perception of a trade-off between performance and social responsibility is increasingly being disproved by the numbers. Whether it's a 2015 Harvard Business School study of 2,300 firms, a growing body of research on how resource-efficient companies outperform their peers, or its own analyses of how higher gender diversity yields better stock performance and lower volatility, Morgan Stanley's Institute for Sustainable Investing confidently summed it up: "We believe sustainability creates business value."[12]

Another institutional investment adviser put it like this:

> *"[W]e have been collecting studies from financial institutions and academic institutions that link ESG performance with financial performance since 2000, and to date we have collected 356 studies, all of which show that more sustainable companies or funds have financial performance that is comparable with, or better than, those of less sustainable peers. ... In sum, there is ample evidence that environmental, social and governance factors are relevant to financial performance; if these factors were all immaterial, it would be difficult to explain how there could be so many studies showing correlations of financial and ESG performance over the past decade and a half."*[13]

Companies and management, too, have begun to take notice, but they face conflicts and collective action challenges that limit their ability to respond. For example, the number of companies issuing sustainability reports has increased, private standard-setters have offered new models for those disclosure, and investors are successfully engaging with companies on ESG matters.[14] Yet, despite these interventions, some of which are costly, ESG information is still incomplete, inconsistent, often low-quality, and weakly unverified.[15] That doesn't even count the legislative, regulatory, and other political efforts that have sought to reduce transparency further.[16] The cost-benefit calculus from regulatory inaction is increasingly high.[17]

Ultimately, much remains to be done to better align investors, managers, and other stakeholders for mutually beneficial long-term results. This report examines the role that improved corporate disclosure could play in boosting long-termism, focused especially on ESG information. As case study examples, the authors focus on inadequacies in the SEC's approach to worker training and to climate-related disclosures, but, as noted, the same analysis could be applied easily to a wide range of ESG matters.

This report recommends that the SEC update its disclosure regime and related tools to better align interests of investors, management, and the public toward long-term economic success and the public interest. Specifically, the SEC should:

- Require high-quality, consistent ESG disclosure on both marketwide and sectoral bases.
- Look to expert, nongovernmental standards or standard-setters for ESG disclosure standards.
- Defend an investor-oriented, public-interest approach to the disclosure mandate.
- Update audit and data tagging standards to boost the availability and reliability of information.
- Empower SEC staff to be the voice of long-termism on behalf of investors and the public.
- Bring clear, bold enforcement actions and support similar actions by states and private investors.
- Boost board attention to corporate long-termism and sustainability.
- Boost shareholder voice in favor of ESG and long-termism.

In his inaugural speech, SEC Chairman Jay Clayton stated that the SEC's analysis "starts and ends with the long-term interests of the Main Street investors ... Mr. and Ms. 401(k)."[18] The world has changed since 1982, when the SEC last meaningfully addressed the ESG information that those Main Street investors can reliably access.[19] It's time for the SEC to ensure that investors and the public get the information they need to better link corporate performance and risk management with long-term results for the American economy.

ESG information promotes corporate long-termism

Publicly listed corporations are essential components of the U.S. economy. They employ millions of Americans, contribute to productivity growth, and provide essential goods and services upon which Americans depend.[20] However, in recent years, a sizable amount of evidence has emerged indicating that these corporations have become too focused on meeting short-term earnings, stock price targets, and market pressures for stock buybacks.[21] Short-term pressures arise, for example, when executive compensation is too closely linked to short-term stock prices. Similarly, so-called activist investors—those who buy a large number of a company's shares with the goal of creating some sort of corporate change—can pressure companies to engage in excessive levels of buybacks of their shares, or otherwise engage in business strategies that maximize short-term gain for investors but undermine the company's long-term economic performance, stability, and social responsibility.[22] The secular decline in business investment in the United States since 2001 appears, in part, to reflect these pressures.[23] Short-termist pressures also have played a role in the decline of American manufacturing.[24]

The debate around how to respond to short-termism has mostly centered, to date, around two concerns: whether and how to limit stock buybacks,[25] and whether to insulate boards and management from investors' influence, activist or otherwise.[26] In "Long-Termism or Lemons," CAP analyzed some of these short-termism market pressures and recommended boosting corporate long-termism by deploying long-term executive compensation plans, limiting share buybacks, and enhancing long-term investors' influence over the company's board of directors.

What has not been as central to the debate as it should be is whether corporate long-termism can be promoted through disclosure. Building on the growing chorus of investors seeking this information for long-term performance and risk management purposes, this report argues that disclosure of the broad range of ESG information can play an important role in aligning the interests of all corporate stakeholders toward long-term, commonly shared interests.

ESG information and its growing impact on public markets

The effectiveness of capital markets in allocating investments, as well as in protecting investors from fraud and undo risks, depends first and foremost upon having a wide availability of information. Today, investors and the public lack critical ESG information that they need to make better long-term-oriented decisions. And as a result, corporate management does not receive sufficient ESG-related signals from the capital markets, which in turn discourages it from taking a long-term-oriented approach.

ESG issues cover a wide range of topics and facets of society that affect, and are affected by, the private sector. Whereas ordinary financial information seeks to present snapshots of the financial condition of the company on topics such as revenues, costs, cash flow, and more, ESG information seeks to present a snapshot of the company's interaction with the physical environment, human beings, and institutional structures. The CFA Institute, which administers the chartered financial analyst (CFA) certification and supports professional standards for the investment industry, lays out a useful sampling of ESG topics.[27]

TABLE 1

Examples of ESG issues

ESG issues crosscut domains and have local, national, and global effects

Environmental	Social	Governance
Climate change and carbon emissions	Customer satisfaction	Board composition
Air and water pollution	Data protection and privacy	Audit committee structure
Biodiversity	Gender and diversity	Bribery and corruption
Deforestation	Employee engagement	Executive compensation
Energy efficiency	Community relations	Lobbying
Waste management	Human rights	Political contributions
Water scarcity	Labor standards	Whistleblower schemes

Source: CFA Institute, "Environmental, Social, and Governance Issues in Investing," October 2015, available at https://www.cfapubs.org/doi/pdf/10.2469/ccb.v2015.n11.1

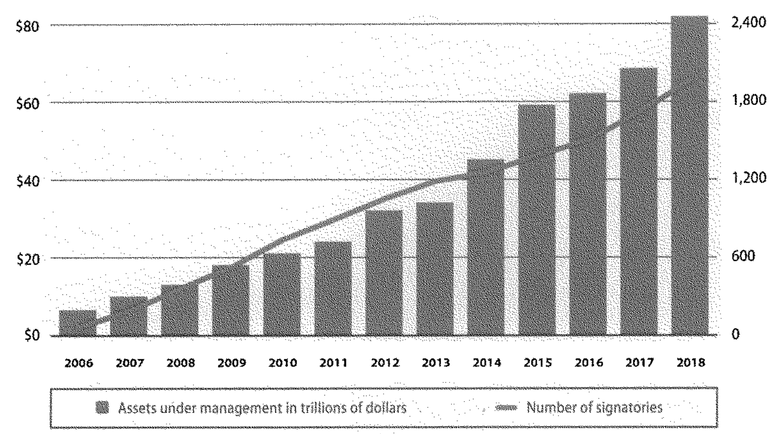
Greater provision of ESG information would empower investors and the public to further and better incorporate long-term-oriented factors into their capital market decision-making, which, in turn, would affect how companies address those ESG and other long-termism matters.

That's exactly what investors and the public are demanding. Investors of all types increasingly recognize that ESG information is an essential part of evaluating potential investments. A recent study found that 82 percent of mainstream, or non-ESG focused, investors considered ESG information when making investment decisions.[28] Moreover, at more than $8.72 trillion in total assets under management as of 2014, investing that takes into account ESG criteria is no longer a niche investment category.[29] The extraordinary increase in the number of signatories to the Principles for Responsible Investment (PRI) makes this clear. The PRI is a network of investors focused on promoting responsible investment through understanding and incorporating ESG factors into investment decision-making. Since its launch by the United Nations in 2006 with just 100 members, the PRI now has more than 1,800 signatories who manage more than $80 trillion in assets.[30]

FIGURE 1

Investors continue to join U.N. Principles for Responsible Investment

Number of signatories and their combined total net assets under management



Source: UN PRI, "About the PRI," last accessed September 2018, available at https://www.unpri.org/about.

Pension plans, which particularly require long-term investment, are increasingly using ESG information in their investment process.[31] Indeed, in response to that demand, the U.S. Department of Labor provided helpful flexibility by clarifying in 2015 that its regulations would not impede investment decisions to use ESG factors as part of the "primary analysis of the economic merits of competing investment choices."[32]

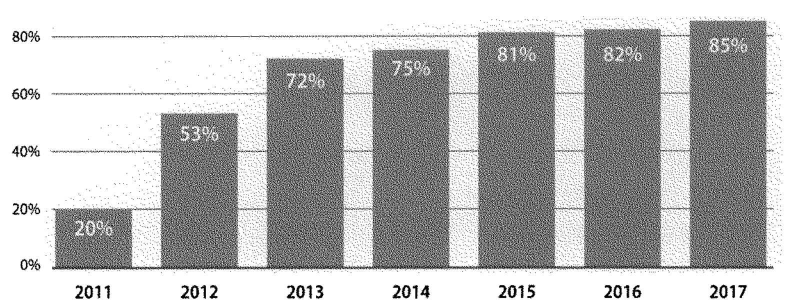
Thousands of asset managers with trillions of dollars in assets under management are not just factoring ESG information into their decisions because they want to do the right thing. It's because ESG information is important for long-term investment success and in particular the management of risk—two core aspects of efficient capital allocation and investor protection. Several reviews of the academic literature, including one survey of 2,000 other academic studies, find a correlation between ESG criteria and corporate financial performance.[33] A range of academic evidence also points to lower costs of capital and other benefits to companies and investors that consider ESG factors in their decision-making.[34]

Expanding ESG disclosure appears to have significant benefits and limited costs, consistent with the experience of disclosure more broadly. Evidence points to companies with strong disclosure practices having positive shareholder returns.[35] These companies also have better stock returns than those with poor disclosure practices.[36] Moreover, as discussed in detail below, with many companies already engaged in various types of information collection and partial disclosure, the additional costs of marketwide and consistent disclosure are limited.

Companies themselves are recognizing the low costs and high benefits of transparency. Despite limited formal regulatory requirements, more companies than ever are making sustainability disclosures. According to the Governance and Accountability Institute, the number of S&P 500 companies making "sustainability reports" increased from less than 20 percent in 2011 to more than 85 percent in 2017.[37]

FIGURE 2
Sustainability reports have become status quo among the largest companies

Percentage of S&P 500 companies producing annual sustainability reports



Source: Governance & Accountability Institute Inc., "FLASH REPORT: 85% of S&P 500 Index® Companies Publish Sustainability Reports in 2017," Press release, March 20, 2018 available at https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html.

Companies are also providing discrete disclosures in response to investor pressure and questioning. For example, many are disclosing that they are using an internal price on carbon to guide decision-making.[38]

The limits of market-driven progress

Demand for, and availability of, ESG information has blossomed in recent years. Yet today's information marketplace is far from working well on its own. The ESG information being voluntarily made available today is not complete, specific, comparable, widely available, or well-verified.[39] Disclosures in SEC filings, which provide the highest standard for reliability, are often weak. Generic and boilerplate disclosures are ubiquitous.[40] Needless to say, all of this limits the information's utility for investors, especially on a marketwide basis.

One study by the Sustainability Accounting Standards Board (SASB) focusing on climate-related disclosures alone found that as of October 2016, almost 30 percent of recent 10-K filings for the 10 largest companies by revenue in each industry do not identify any climate risks.[41] Forty percent of companies have boilerplate disclosures.[42] And even where disclosures have improved, comparisons of companies across a given industry are difficult, if not impossible, without the standardization of metrics and greater requirements for qualitative descriptions.

Ultimately, investors themselves have been overwhelmingly clear about the need for expanded disclosure on worker pay, training, benefits, and diversity; on environmental matters such as climate; on financial stability matters such as derivatives exposures; on human rights risks; on political spending; on tax strategies and risks; and more.[43] Each of these areas makes a persuasive case for how additional disclosure would boost the long-term alignment of interests among investors, companies, and the public.

The two case studies below illustrate the benefits of additional ESG disclosure for corporate long-termism, as well as the significant weaknesses in the disclosures available today.

Worker training

America's working class have been under tremendous economic pressure in the past 15 years. The middle 60 percent of households have seen their incomes stagnate, and since 2000, workers without college degrees have seen their wages decline by 2 percent, while those with college degrees have seen a 3 percent increase.[44] Meanwhile, there are 4 million fewer Americans with jobs than there were in 2000, as demonstrated by the prime-age labor force participation rate.[45] On top of that, the financial crisis helped wipe out nearly 50 percent of the net wealth of the average middle-class household—comparing 2010 with 2001—and it has yet to fully recover.[46] In some regional economies and some demographics, the pain has been even more acute.[47]

As worker training can be seen partially as a worker benefit, it should, perhaps, not be surprising that between 2001 and 2009, employer-provided training declined by more than 27 percent, the largest portion of which took place before the 2008 financial crisis and Great Recession.[48] That parallels the collapse in business investment that has also occurred since 2000, cited as key evidence of corporate short-termism.[49] And in fact, they are both disturbing: A range of studies shows how on-the-job training is important for boosting productivity for workers, firms, and the entire economy.[50]

Short-term financial market pressures to reduce costs are not the only reason companies are under pressure to reduce workforce training investment.[51] Factors such as declining employee tenure, declining compensation, and other structural factors matter a great deal, but capital markets pressures are real. Because human capital investments are not broken out from other general and administrative expenses, companies that make those investments look less efficient than others. With markets placing maximum pressure for—indeed, excessively valuing—buybacks and dividends today over investments that are likely profitable in the future, the impact of lumping workforce training into general and administrative expenses is likely magnified.[52]

The good news is that there is a ready model for how disclosure can help reduce this conflict. Prior to the 1970s, spending on research and development (R&D) was specifically disclosed and appeared in various ways, ranging from general and administrative expenses to capitalization.[53] Since the Financial Accounting Standards Board mandated specific disclosure in 1974, R&D investment has become an important financial statement disclosure that investors look at to determine whether a company is innovative and investing for the future.[54] And unlike workforce training, R&D investment by U.S. companies has risen, with R&D investments now exceeding capital asset investments.[55]

CAP has argued that a stand-alone disclosure requirement for workforce training would improve how financial markets view worker training. In 2017, the Human Capital Management Coalition, a group of institutional investors representing $2.8 trillion in assets, agreed and petitioned the SEC to significantly expand disclosures on workforce training and other workforce issues.[56]

Corporate disclosure of workforce training investment and other worker issues is only one piece of a larger series of policy changes that are needed to improve economic outcomes for American working families.[57] But they present an achievable opportunity to better align long-term interests among investors, companies, and the public.

Climate

Climate change is a central example of where greater ESG disclosure could better protect investors and achieve better capital allocation in the public interest. Climate change poses enormous risks and opportunities for the corporate sector, ranging from oil industry asset valuation to negative impacts on crops, coastal property, supply chains, and more.[58] Yet, corporate disclosure available today is insufficient, not comparable, and unreliable.[59] This limits the effectiveness of the capital markets in doing their basic job of allocating capital to the best available private market uses.

Climate change presents risks to both investors and the broader economy. A 2015 estimate of value-at-risk (VaR) associated with climate change by *The Economist* found that expected losses to the private sector from a warming planet could amount to $4.2 trillion by 2100, discounted in present value terms.[60] As the publication notes, this is approximately the same size as Japan's entire annual gross domestic product (GDP) or as the total value of all the world's listed oil and gas companies.[61] *The Economist* also analyzes the risk of a 5-degree or 6-degree warming scenario and finds private sector losses ranging from $7 trillion to nearly $14 trillion, respectively.[62] Public sector costs would add an additional $43 trillion in estimated losses over the next 80-plus years.[63] Focusing specifically on U.S. publicly listed companies, climate risks to corporate America are widespread.[64] One estimate finds that the overall market cap of affected assets is $27.5 trillion, which is 93 percent of the U.S. equity market value.[65]

With the U.S. government engaged in wide-ranging environmental and other forms of deregulation, investors and the public recognize that the capital markets now play an outsized role in countering some of those impacts.[66] This would be primed to occur through the basic functioning of the capital markets: pricing and managing risks. But widespread and consistent disclosure is important, because climate disruption poses marketwide and even systemic risks to the financial system and economy.[67] Failure to accurately price investments has caused financial crises in the past and preventing such mispricing is one of the SEC's most fundamental mandates dating back to its founding legislation in 1934.[68] ESG disclosure for climate would also help the capital markets better seize opportunities to deploy capital that can achieve both economic and social returns.[69]

Investors need to consider climate across a diverse portfolio, but the issue is important to the entire economy, and the public would benefit from the transparency provided by the capital markets. Jobs, livelihoods, and entire communities will feel the effects of whether America's largest corporations effectively respond to climate disruption or not.

The SEC's 50-year struggle with corporate ESG disclosure

Investors and the public have long sought information about what are now considered ESG matters. Nearly 50 years ago, the National Resources Defense Council and several other public interest groups petitioned the SEC to adopt rules requiring various environmental disclosures and disclosures regarding equal employment opportunities.[70] This kicked off nearly a decade of rule-making and judicial processes, ultimately leading to new disclosure obligations—although many fewer than were originally sought. The process was unprecedented at the time, and, as the appellate court that reviewed the case noted, the public's engagement was considerable. For example, in the summer of 1975, the SEC held weeks of hearings, wherein it heard more than 50 oral presentations and in a simultaneous comment period, received more than 350 additional comment letters, creating a record of more than 10,000 pages.[71]

Clearly, these issues were important to participants on all sides, yet out of this process, the SEC only added modest disclose requirements regarding material compliance with environmental laws and litigation. The effort to secure disclosure regarding equal employment opportunities were not successful.[72]

Fast forward to 2016, when the SEC issued a concept release to revamp its corporate disclosure framework, it received more than 26,500 comments from investors and the public.[73] An analysis of these commenters showed that the comments overwhelmingly and persuasively felt that ESG disclosures were significantly lacking across a wide range of issues.[74] All of that is on top of a succession of efforts by investors and the public to push for greater disclosure on a range of specific topics, such as political spending where more than 1.2 million commenters registered their views with the SEC.[75]

To understand why these overwhelming ESG gaps remain today, it is important to step back and understand the overall framework for corporate disclosure by the SEC.

Background on the SEC corporate disclosure framework

In the aftermath of the stock market crash of 1929, Congress established regulatory oversight of the capital markets, in particular mandating that the companies who offered securities for sale to the public provide wide-ranging transparency regarding their businesses. That was accomplished through the mandates of the Securities Act of 1933 and the Securities Exchange Act of 1934, as well as the newly created SEC.[76]

The federal securities laws and the SEC have essentially adopted two approaches for requiring corporate disclosures necessary to protect investors and promote the public interest. First, the federal securities laws and SEC regulations set out specific, required disclosures covering many aspects of the company's business, including its risks and its ownership structure. These requirements are also tailored to address various contexts, such as when a company offers shares to the public or when it provides ongoing reports of its operations and financials.[77] Second, the federal securities laws establish an overarching anti-fraud principle requiring a company's disclosure to be materially accurate and complete. To ensure these disclosure obligations are met, the federal securities laws empower the SEC to oversee corporate filings and, through regulatory tools, act as gatekeepers between companies and the capital markets. In addition, both the SEC and harmed investors can recover in court for violations and harms.[78]

Since 1982, the SEC's Regulation S-K has been the primary source of specific disclosure requirements for public companies.[79] It forms the backbone of what companies disclose in their most important public filings, in particular their annual Form 10-K filing with the SEC.[80] This cornerstone securities regulation is divided into several subparts, each of which covers a specific topic.[81]

Let's take climate disclosure as the example to illustrate how the existing disclosure framework works with respect to an ESG topic. There currently are no climate-specific disclosure mandates, but climate disclosures may be triggered by more general disclosure requirements in Regulation S-K. These requirements arise principally in items 101, 103, 303, and 503 of Regulation S-K.

Item 101 requires companies to disclose basic general information about their businesses. Paragraph (c)(xii) of Item 101 specifically calls for companies to disclose "the material effects that compliance with [environmental laws] may have upon the capital expenditures, earnings and competitive position" of the company, as well "any material estimated capital expenditures for environmental control facilities."[82]

Item 103 requires companies to disclose "any material pending legal proceedings."[83] The instructions specifically direct companies to disclose environmental proceedings if any one of three conditions are met, one of which is that a government is bringing an action that the company "reasonably believes" could result in sanctions of $100,000 or more.[84]

Item 303 requires disclosures that are intended to "communicate to shareholders management's view of the company's financial condition and prospects."[85] These disclosures comprise the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) portion of SEC filings. Climate change issues may be disclosed here to the extent that they may be of interest for companies' management, such as potentially affecting earnings, cash flows, or broader strategy.

Lastly, Item 503 requires disclosure of the most significant factors that make an investment in the company "speculative or risky," commonly called "risk factors."[86] Again, to the extent that climate change or regulations related to it may have uniquely significant impacts on the company, they should, at least theoretically, be disclosed here.

Each of these disclosure obligations are highly dependent on management's judgement about the magnitude of these issues' impact on companies' operations or financial position or likelihood of occurrence. MD&A sections, in particular, are not audited and, given the generality of the overarching requirement, are difficult to enforce. Risk factor disclosures, moreover, are often overwhelmingly boilerplate with little decision-useful information, and instead take a laundry-list approach to potential risks.

Investors and the public are left, absent other SEC or court intervention, largely at the mercy of whether a company's management determines to disclose or not. And indeed, that is exactly the implication of a principles-based approach disclosure, which has increasingly characterized the SEC's approach to disclosure.[87]

Slow and stalled progress toward ESG disclosure requirements

The SEC's disclosure regime outlined above has been mostly frozen on ESG matters—and indeed on most substantive matters—since the 1980s.[88] But that is not for a lack of trying by investors and public interest groups. For decades, they have pressed the SEC to update its expectations, yet little progress has been made.

Climate change, the subject of some of the most persistent and creative investor efforts, is again a good example of the limits of what has been achieved to date, in part because it has seen more progress at the SEC than have other areas. However, the SEC's analysis and approach to climate-related matters are equally applicable to other ESG matters.

In 2010, after years of efforts and a petition from more than two dozen organizations,[89] the SEC issued an interpretative release that advised companies of several distinct areas in which climate change risks may need to be disclosed.[90] The guidance offered four areas in which climate change-related issues could give rise to disclosure obligations:

1. Impact of legislation and regulation
2. International accords or treaties
3. Indirect consequences of regulation or business trends
4. Physical impacts.

This guidance did not revise the specific disclosure elements of items of Regulation S-K. Instead, it offered scenarios in which companies "may" or "could" have a disclosure obligation under the above-referenced framework due to the impacts of certain climate or climate-related regulatory risks on the companies' financials, operations, and more.[91] This quintessentially soft-touch approach barely moves the needle on disclosure obligations and once again relies heavily on management's judgment and company-by-company oversight by the SEC.

Nevertheless, things were promising starting out. Following the 2010 release, the SEC began sending interpretive letters and other correspondence to companies and asset managers for various climate change-related issues. But without improvements in quality, the SEC's focus nevertheless waned: The commission sent 38 comment letters in 2010, 11 in 2011, three in 2012, and none in 2013.[92] Moreover, enforcement has not played a role in the SEC's efforts on this front. A recent Government

Accountability Office (GAO) report on the topic noted that senior SEC staff "did not expect changes in companies' climate-related disclosures as a result of the 2010 Guidance since SEC did not adopt any new disclosure requirements"—a somewhat stunning admission regarding the guidance's impact.[93]

Separately, in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Congress stepped in to mandate a number of other ESG disclosures, including the ratio between CEO pay and that of the median worker; information about conflict minerals; information on mine safety; and information on resource extraction-related payments.[94] These disclosure mandates have been criticized as serving political or special interest ends that would otherwise not be appropriate to the federal securities law.[95] While some of those provisions were both overly prescriptive in certain details and insufficiently broad to cover the real range of ESG issues related to worker safety, human rights, and such, the provisions nevertheless reflect an effort by Congress to advance investor protection values related to ESG disclosures.

For example, the pay ratio, which compares the salary of the median employee with that of the CEO, sheds important new light on employee compensation. Because pay is both a complex and sensitive topic, the ratio offers a sensible, cost-efficient approach that is helping investors cast informed votes on matters related to executive pay and human capital management.[96] In particular, it provides an important window into whether companies are investing and retaining their workers in a manner sufficient to motivate employee productivity.[97] In short, being incomplete does not negate the fundamental value of the disclosures for boosting the long-term alignment among investors, management, and the public interest.

Moreover, Congress seemingly rejected the critique of political or special interest disclosures when, with little controversy, it mandated disclosures of Iran-related business activities in the Iran Threat-Reduction and Syria Human Rights Act of 2012.[98]

Investors and the public resort to private market self-help

Faced with little movement by the SEC, shareholders and others have engaged in a range of private market strategies to improve ESG disclosures and boost corporate long-termism. They may directly engage companies, often through investor calls or direct outreach to management.[99] They may put forth proposals under the SEC's Rule 14a-8, which enables shareholders to vote on certain topics.[100] They may seek to change the composition of a company's board of directors to better reflect their concerns. Or they may vote with their investment dollars and divest or otherwise change their capital allocation.[101]

Each of these unilateral efforts by investors has its appropriate role in corporate long-termism, as well as investor protection.[102] Sometimes they have achieved surprising success at driving marketwide change.[103] Ultimately, though, they have not been able to replace the direct regulatory action needed to achieve broad-based and consistent disclosure and accountability. Below are a few of the more notable efforts by investors and other stakeholders to fill the corporate long-termism void left by inadequate ESG disclosure requirements under Regulation S-K.

Shareholder proposals and engagement

The SEC's Rule 14a-8 enables shareholders to petition to have specific proposals included in the company's proxy, which allows all shareholders to express their views to the board and management. The rule, which dates back to 1942, has grown in significance since the 1980s.[104] It has become an important tool for investors to help companies manage new and emerging risks, especially in ESG areas on which management is often not well-attuned.[105] Shareholder proposals also drive engagement with management, as those who pursue these initiatives regularly work with management to obtain a responsible, productivity-enhancing result without a vote.[106]

Shareholder proposals have achieved notable successes in the ESG area. Together with the engagement they have driven, proposals have helped push companies toward what is now the standard practice of having independent directors constitute a majority of the board.[107] More recently, shareholder proposals were essential in pushing what is now a substantial majority of companies to have sexual orientation nondiscrimination policies.[108] In the area of political spending, shareholder proposals have secured the cooperation of 160 companies and more than half of the S&P 100 in disclosing and instituting board oversight over political spending.[109]

This represents extraordinarily important progress, but it has limits. In particular, the company-by-company approach—and, commonly, resistance by management—constrain its ability to set out consistent, comparable, and reliable disclosures marketwide.[110] In addition, while some asset managers are leaders in pushing for corporate long-termism, not all are.[111] And some asset managers do not support shareholder-led proposals on any issue.[112]

Exchange listing standards

In part at the urging of the PRI as part of its implementation of the United Nations' Sustainable Development Goals, stock exchanges around the world have encouraged more disclosure of ESG issues.[113] Exchanges have long played a role in setting regulatory requirements, including disclosure requirements, across their listings. Working with the U.N. Sustainable Stock Exchanges Initiative, Ceres, and others and soliciting the input of institutional investors around the world, the World Federation of Exchanges issued guidance in 2015 on how each exchange could approach implementing its own ESG reporting requirements.[114]

As of 2018, more than 40 stock exchanges around the world have either published or are committed to publishing ESG disclosure guidance, including the leading stock exchanges in Australia, China, Hong Kong, India, Sweden, and the United Kingdom and, as of 2017, the Nasdaq Stock Market in the United States.[115] In addition, a new effort is underway in the United States to create a "Long-Term Stock Exchange" that would adjust investor rights and disclosure toward a longer-term approach.[116]

The particulars may vary, but the efforts represent meaningful consensus that progress is important and possible. They remain, however, largely voluntary and are not necessarily consistent across exchanges, including within the United

States.[117] Investors and other stakeholders continue to urge more progress, but the economics underlying for-profit competition among exchanges undermine their ability to play market-setting regulatory roles.[118]

Global leadership on ESG

Internationally, European policymakers are working to expand ESG disclosures. EU Directive 2014/95/EU sets ESG reporting requirements for large public companies.[119] Companies must provide nonfinancial information in corporate reports or separate filings on a variety of topics. The directive has the force of law, and EU members are responsible for transposing the directive into law and ensuring compliance.[120] Individual countries are also moving toward requiring disclosures by investors about how they factor in ESG issues into their investment decisions.[121]

Sustainability reports and investor-led questionnaires

As mentioned above, more companies are publishing sustainability reports than ever before. The wide adoption of sustainability reporting represents progress in companies providing investors and the public with important ESG information. However, standardization, detail, completeness, and reliability remain challenges.

The most widely used standards for sustainability reporting are set out by the Global Reporting Initiative (GRI), an international organization comprising investors, companies, and governments.[122] The GRI has done important work to improve sustainability reporting, and nearly 9,600 organizations worldwide have integrated the GRI framework, and many prominent U.S. companies use GRI guidelines in their corporate sustainability reports.[123] GRI guidelines cover a wide variety of business indicators, including procurement practices, biodiversity impacts, and labor-management relations.[124]

As noted above, however, sustainability reporting has significant limitations. These stand-alone reports differ from basic SEC-mandated corporate disclosures in that they are not standardized, are not verified by outside auditors to the same degree, and are not accountable to the same degree. They often look more like public relations documents than rigorous disclosure documents. Also, sustainability reports rarely contain detailed quantitative information and even more rarely disclose information that does not project a positive image of the company—a practice occasionally labeled "greenwashing."[125] Companies with even the highest-quality sustainability reports failed to include 90 percent of their known negative events.[126] Because information is not audited to a high standard, reliability is weak. A 2013 study of more than 4,000 sustainability reports uncovered omissions, inaccurate data, and unsupported claims.[127]

Nevertheless, as noted above, sustainability reports signal that companies acknowledge the importance of this information to investors and the general public and that they can and do produce a wide range of worthwhile information.

Information compilation and rankings

To the extent that sustainability reporting seeks to present solely a positive public image, it will be limited in its utility. Investors and public interest groups have sought to counter this is by instead directly creating a marketwide expectation of disclosure.

The innovative work of CDP—formerly the Carbon Disclosure Project—represents one of the most effective efforts of this type. Since 2003, it has requested specific quantitative and qualitative environmental disclosure via direction questionnaires sent on behalf of investors. CDP then compiles and makes the information available to investors.[128] Today, more than 6,300 public and private companies worldwide respond to its questionnaires, which cover governance; targets and initiatives; emissions; and methodology around climate change, water, forest practices, and more—giving those with access to the CDP platform an impressive array of information.[129]

Efforts are also underway to review and rank companies based on independently available information. The Center for Political Accountability's (CPA) CPA-Zicklin Index benchmarks and ranks companies for their political disclosure and accountability practices.[130] In 2017, JUST Capital made publicly available information and rankings of companies on ESG criteria, such as worker pay, benefits, environmental protection, and consumer privacy protection.[131] The Asset Owners Disclosure Project engages in similar rankings for asset managers and investors such as pension funds and insurance companies, putting pressure on companies through the practices of their investors.[132] A range of private ratings firms also offer ESG ratings on companies.[133]

These and other efforts to compile information directly from companies or from external sources provide investors and the public useful information and ultimately add to the pressure on companies to take a long-term approach. Yet, the costs of these divergent approaches add up, and there are limits to what each of them can do on their own.

Standard-setting

One of the most important self-help approaches to date takes the form of private standard-setting. The activities of GRI and CDP, mentioned above, are some the earlier standard-setting activities associated with the development, respectively, of sustainability reports and questionnaires. In both cases, their work focused on facilitating disclosure through nonmandatory reporting channels. More recently, though, private associations of investors, market participants, academics, and others have established frameworks for what ought to be disclosed through existing mandatory regulatory reporting channels.

Of particular importance is the SASB, which has promulgated sector-by-sector standards for companies to disclose ESG information in their SEC regulatory filings. The SASB's framework seeks to apply existing—and hence, in theory, mandatory—minimum standards under current law.[134] Its requirements arise from looking at ESG items that would be material to companies in a particular sector, taking the approach to materiality that the Supreme Court has set forth in an enforcement context—see discussion of materiality below.[135] Although some have critiqued its approach to materiality as being too permissive for a disclosure standard-setter and the structure too focused on MD&A, the SASB's effort nonetheless represents a highly practical step forward in bringing standardization, quality, and accountability to information. Additionally, the SASB's sectoral approach has important strengths, as ESG risks can vary by industry; it has set out disclosure standards for nearly 80 industries.[136] The SASB's work has attracted the interest of investors, companies, market professionals, and regulators, but ensuring uniform takeup across companies will require regulatory and enforcement teeth.

Taking a somewhat different approach, Integrated Reporting <IR> is a set of standards, available since 2013, which builds ESG matters directly into companies' businesses and accounting frameworks by measuring six types of capital within a corporation—financial, manufactured, intellectual, social and relationship, human, and natural.[137] it attempts to change the way companies and markets value what they do, and valuation lies at the heart of financial reporting and thus corporate disclosure.[138] It is mandatory in South Africa and has been adopted voluntarily by some companies around the world.[139] Challenges remain in the United States, however, with respect to its takeup and the completeness of disclosure.[140]

Litigation

Investors and public interest advocates, including state attorneys general, have begun to resort to litigation to advance companies' ESG disclosures.[141] Perhaps the most important of these efforts have proceeded under the auspices of fraud investigations led by the New York attorney general, who has a broad ability under the Martin Act to investigate potential financial fraud.[142] In particular, in 2007 it began investigating several major international energy corporations for failure to disclose climate change risks to investors, and in January of this year sued five of the world's largest publicly listed oil companies.[143] The SEC opened and then recently shut an investigation into at least one of these companies.[144]

Private litigation, which is important for both deterrence and recovery, is also available. Some of these private litigation efforts have been able to tackle false or misleading statements in corporate sustainability reports, including, to some extent, omissions.[145] However, given the expense, risk, and practical litigation challenges—especially in a world of heightened pleading requirements—private plaintiffs are also unlikely to be able to shoulder the burden of testing and reforming today's ESG disclosure regime.

Recommendations

Rather than relying on a patchwork of voluntary initiatives, the ESG disclosure that investors and the public need demands direct regulatory action at the SEC. This falls squarely within SEC core competencies and mandates, and no new statutory authority is required for almost everything outlined below. However, should the SEC continue to fail to act, Congress should step in to force the SEC's hand with clear, strong, and broad mandates.

Here, specifically, is what needs to be done.

Require high-quality, consistent ESG disclosure on marketwide and sectoral bases

For the promise of corporate long-termism to work, the SEC must commit to ESG transparency. That commitment must extend to enhancing both market-wide and sectoral-specific information.

First, the SEC should establish explicit disclosure requirements for ESG matters that are generally applicable to all corporate filers. Called line-item disclosures, these would need to be updated from time to time, but a good starting place for what should be required are the ESG items for which investors and the public have already requested additional disclosure—most recently in the 2016 Concept Release on Regulation S-K. As noted above, that list would presumably include employee pay, training, benefits, and diversity; climate- and weather-related risks and impacts; financial stability matters; human rights-related risks; political spending; and tax strategies and risks.[146] The SEC may also look to what other disclosure platforms and standard-setters—such as the GRI, CDP, SASB, and <IR>—have proscribed as being reasonable indicia of investor demand.

It would be important, however, for the SEC to remain flexible, monitor market developments, and make adjustments as appropriate—all with the goal to enhance the alignment of interests among investors, the long-term performance of companies, and the public. With other short-term pressures still present in the marketplace, careful attention to practical outcomes, as well as the interplay of disclosure, board stewardship, asset manager engagement, and shareholder voice—discussed below—will be important to achieve the desired goal of corporate long-termism.[147]

Flexibility would be aided were the SEC to experiment with a petition system whereby it would consider the appropriateness of a new disclosure topic based on a certain threshold of investor or other stakeholder interest. Doing so would encourage investors and other corporate stakeholders to weigh in with the SEC and may provide the SEC with better information on the gaps between what investors want and what companies give. These petitions could result in analysis and investor testing by SEC offices such as the Division of Economic and Risk Analysis and the Office of Investor Advocate, so as to prepare the ground for broader agency action.

The SEC should also enhance sectoral disclosure by updating its industry guides for relevant ESG matters. Additionally, the SEC should review disclosures that companies are required to make available through other government agencies and take steps to make them more accessible to investors.[148] This could potentially be achieved by directing companies to incorporate the disclosures in their SEC filings.

A balance must also be struck between specificity, which can yield information that is more comparable across companies, and flexible approaches that elicit useful information across a range of circumstances. As such, the SEC should also adopt a catch-all mandate for ESG disclosure that, for example, could mandate that companies make quantitative and qualitative disclosures regarding factors that influence or threaten their long-term sustainability.[149]

In adopting line-item standards, the SEC should especially consider systemic impacts. This means expanding its focus from simply those items that have an impact upon a given company. Some topics may require looking at marketwide impacts, even if one company's impacts may be relatively modest. This broader approach is important not only to align incentives marketwide, but also for investor protection. Today, investors are diversified and must attempt to evaluate systemic risks. Whether the issue is climate change, inequality, or diversity, there is a wide range of matters increasingly being recognized as systemic risks.

Ultimately, the cost to investors from attempting to collect this information in today's environment is high; the costs to investors from failures to manage those risks is also high. The SEC should also remember that the cost to companies from disclosing activities or data that may have some impact upon ESG matters within their purview is relatively low.[150] In addition, to support a marketwide approach, it may be time for the SEC to consider applying new ESG disclosure mandates to companies not yet publicly listed but which otherwise have reached a certain size, scope, or number of shareholders.[151] This would address the rapidly growing universe of nonpublicly listed, but otherwise large and economically important, companies[152] and would also be consistent with the SEC's consideration of expanding access to nonpublicly listed companies to a greater range of potential shareholders.[153]

Look to expert, nongovernmental standards or standard-setters for ESG disclosure standards

The SEC has long retained direct control over its line-item corporate disclosure requirements. In certain areas, however, it has looked to external organizations for detailed regulatory expertise that it was not well-positioned to provide. The SEC has long relied on external accounting expertise to establish the accounting principles that form the backbone of financial disclosures.[154] Over the years, Congress and the SEC have increased regulatory oversight of accounting standard-setting and boosted its independence from industry.[155] Yet, private-public-mixed standard-setting continues to function adequately and fills expertise gaps that would not necessarily be better met wholly within the SEC.

In 2003, the SEC again looked to this model with respect to standards for internal controls when it pointed to the framework set by the Committee of Sponsoring Organizations of the Treadway Commission, a private standard-setting initiative focused on reducing corporate fraud.[156] As that private sector standard became increasingly recognized as high quality, the SEC, in adopting its own requirements to crack down on corporate fraud, required companies to use "a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment."[157]

ESG information may offer a similar case for looking to an external standard-setting entity, subject to SEC oversight. ESG information extends beyond the areas of corporate financial reporting that the SEC has tended to know best. A public-private standard-setter may also be more flexible in integrating a range of viewpoints, including investors, management, other corporate stakeholders such as workers, and the public interest, especially if the entity is empowered with sufficient investigative authority. Such an entity might also be better able to navigate the evolving nature of companies and ESG concepts themselves, as innovative businesses create, and long-termism-focused investors identify, new ESG areas that need to be addressed.

The SEC might consider a step-by-step or mixed approach. For example, it could look to the SASB to apply its disclosure framework within the MD&A and/or as supplements to the SEC's industry guides, even while the SEC itself directly set out line-item mandates applicable marketwide. It could also initiate a pilot project to apply <IR> to certain sectors or subsets of companies.

The SEC could also move companies to adopt these standards through the comment letter process or through enforcement—both further discussed below. The SASB and others assert that current law already requires the disclosure of ESG matters.[158]

Regardless, the SEC would need to set out both substantive requirements and process protections that it would expect a new standard-setter to cover. Moreover, it would need to be attentive to the risks of capture.[159] Properly designed governance structures can help ensure a more responsive, public interest-oriented process.[160] In particular, corporate and professional service providers that work for them should not wield an effective veto power over what investors and the public determine should be disclosed. Public accountability and transparency, such as through regular testimony before the SEC's Investor Advisory Committee, are important protections against capture, as are stable funding sources free from special interest interference.[161]

Defend an investor-oriented, public-interest approach to the disclosure mandate

Materiality is frequently called the touchstone for what companies should be required to share under the federal securities laws, but the SEC's disclosure authority is actually much broader.[162] Yet, an unfortunate trend has been afoot not only to ignore the SEC's broader disclosure authority, but also to twist materiality into being a disclosure standard that looks to a matter's significance to the company financially, or otherwise provides the company overwhelming discretion regarding what to disclose.[163] A troubling trend in disclosure requirements has been to insert a requirement that a matter need be found—for all practical purposes by management—to be "material" before being disclosed, with little transparency into how the company reached that materiality determination at all.[164] That is unfortunate because the purpose of materiality as a disclosure standard is totally different: It is to examine whether information is important to a "reasonable investor."[165]

Moreover, overreliance on management determinations of materiality makes the sufficiency of disclosure, as a practical matter, extraordinarily hard to review. As the GAO pointed out in its recent report, SEC staff reviewers, absent an enforcement action, are not well-positioned to have access to the information that management uses when it makes these sorts of determinations.[166] Private investors are even less well-positioned.

It is important to recall the purposes of both that standard and the broader authorities of the federal securities laws. They exist because most investors, especially ordinary retail investors, would not otherwise be able to obtain the information they need to make good decisions to invest or manage their investments. Remembering this most basic purpose should help make clear why the SEC needs to resist twisting materiality into being something that it is not: a way of limiting disclosure on behalf of companies, to the detriment of marketwide comparability, rather than a way of examining whether disclosure is important to investors and the broader public interest, to the benefit of greater information availability.

Measuring or determining materiality is sometimes difficult. It is not a purely economic concept solely relating to the present-day or market-moving value of the firm's securities.[167] It is—and has long been—what investors and the public deem important in decisions that they may make, such as buying or selling stock; voting proxies; engaging the company; and working with stakeholders such as workers or communities.[168] As a practical matter, this means that when the demand for information by investors and the public reaches a threshold, the issue becomes material for the purposes of disclosure.

Take corporate political spending; more than 1.2 million comments have been submitted to the SEC in support of requiring corporate political spending disclosure, including from retail and prominent institutional investors, workers and other corporate stakeholders, public interest groups, and many members of the general public.[169] Also, investors have been winning numerous shareholder proposals on the topic, despite significant obstacles in their way.[170] Yet, it is frequently critiqued as not material, owing to what is often portrayed as small amounts of spending for a large company.

But these investors are onto something. The lobbying behind the 2017 tax bill suggests that relatively small amounts of money for a company can make meaningful differences to a company's and its executives' pocketbooks.[171] Not only does the SEC regularly requires disclosure regarding financial amounts or other information that is numerically small compared with the size of the company, but the SEC has even "long recognized that investors may well have an interest in matters beyond the issue's direct relevance to the company's profits and losses."[172] In short, materiality points to what investors want to know—for their own reasons, including simply in the public interest—and should not be used as a means for management, regulators, and courts to second-guess investors.

That does not mean, however, that management should have to guess what should be disclosed.[173] Indeed, the SEC and the line item disclosures embedded in the original Securities Act of 1933 were put in place precisely to solve that problem: to stand in the place of investors and force the asking of clear, specific questions, via disclosure, that investors would ask of companies if they could do so themselves.

Update audit and data tagging standards to boost the availability and reliability of information

Auditing, whereby independent auditors check and opine on the reliability of management's numbers, protects investors and markets by ensuring high-quality information. Currently, standards for auditing ESG information are less demanding than those for financial reporting, as they still operate under industry-set standards adopted on an interim basis by the PCAOB upon its creation in 2003.[174] The PCAOB, with the encouragement of the SEC, needs to update its audit standards for ESG information and should take new steps toward enforcing it vigorously.

Through its oversight of board audit committees, the SEC should push audit committees to engage in the same level of oversight for ESG matters as for that of ordinary financial information. It should also require the adoption and disclosure of policies and procedures with respect thereto, as well as appropriate policies regarding committee composition—see also discussion regarding ESG and board membership below.[175]

The SEC should also require that data for all corporate filings, including ESG information, be provided to investors in a machine-readable—or "structured data"—format embedded directly in the disclosure document, known as Inline eXtensible Business Reporting Language (Inline XBRL) and subject to the same level of audit and accountability as any filing.[176] This would be an extension of the SEC's rule, finalized in 2018, that requires financial information be provided via Inline XBRL.[177] Utilizing an Inline XBRL format reduces the cost to investors of accessing data and increases its reliability, as it promises to reduce the incidence of errors compared to when structured data is provided as a separate attachment.[178]

Empower SEC staff to be the voice of long-termism on behalf of investors and the public

Every day, the SEC staff are on the front lines of investor protection and corporate long-termism, and SEC Chairman Clayton was right to identify this as a key principle of the SEC's work.[179] One of the most important tools that could boost corporate long-termism are comment letters issued by the Division of Corporate Finance to companies on their disclosure filings. The division does this to boost the consistency and quality of corporate reporting and compliance with Regulation S-K, short of having to bring an enforcement action. The practice of issuing comment letters has waxed and waned, especially on particular matters, and the drop-off in comment letters on climate disclosure has been blamed, in part, for the ineffectiveness of the SEC's 2010 climate guide.[180] A more consistent application of comment letters with respect to ESG would help minimize uncertainty for companies on how to comply with current legal requirements for disclosure and would be a cost-efficient, targeted approach to enhance long-term-oriented disclosure.

To help the division do this, the SEC should boost staff training on ESG and other long-termism matters and expand the use of externally sourced technical experts. Given the availability of technical expertise across the federal government, it seems hard to understand why the SEC does not already have a robust program for staff training and the utilization of technical expertise on a range of topics.

Bring clear, bold enforcement actions and support similar actions by states and private investors

Enforcement is the foundation of compliance with the federal securities laws and accountability to the public. By failing to bring any meaningful enforcement cases on ESG disclosures, the SEC has been sending a signal for years that ESG disclosures and the corporate long-termism they drive are not regulatory priorities.

This is something that the SEC can change right now. The SEC should bring targeted enforcement cases using its current authority to support the states and private investors that, as discussed above, have already begun to act.

Moreover, it is critical that the role of private enforcement of the securities laws be respected and supported, as the health and reliability of capital markets depends upon them. To ensure that public interest attorneys and individual plaintiffs can continue to play a constructive role in enhancing disclosure, the SEC should resist efforts at the federal or state level to curtail or undermine investor access to courts or to class actions.[181] Moreover, the SEC and courts should vigorously resist the inappropriate use of freedom of speech arguments to shut off legitimate investigations and enforcement actions related to companies' failure to disclose known risks.[182]

Boost board attention to corporate long-termism and sustainability

The thesis of this report is that mandatory ESG disclosure can enable private market forces to help align the interests of corporate management with the long-term interests of investors and the public. But as prominent lawyer Martin Lipton has argued for years and most recently set out for the World Economic Forum, corporate boards are places where the rubber can meet the road in establishing a corporate long-termism culture and supporting that with the appropriate incentives.[183] To make that happen, boards should boost expertise, attention, and accountability to long-termism generally and ESG specifically.

Research has shown that board attention yields results, finding for example that a higher level of independent directors and other forms of board focus result in less fraud and more voluntary disclosure.[184] Research has also noted that independent directors have been associated with greater focus on shareholder interests, as opposed to other corporate priorities.[185] Attention and composition thus both matter.

Board membership is a useful starting place for boosting board attention to ESG. Investors have for years sought to boost board diversity, both itself an ESG goal as well as a tool for advancing long-termism more broadly. Led by the New York City comptroller, investors have been calling for disclosure to help them evaluate board diversity.[186] A bipartisan Senate bill also called for specific disclosure regarding cybersecurity expertise on the board.[187] Sen. Elizabeth Warren (D-MA) recently put forward a bill to make corporate governance accountable to stakeholder interests and to require that worker representatives make up at least 40 percent of board membership.[188] More broadly, the benefit corporation movement, by adding a public purpose to the company charter, has deployed state fiduciary duty law to encourage boards be more attentive to the long-term public interest.[189]

The SEC should advance long-termism by building upon these proposals. It should mandate disclosure of the expertise, experiences, and attributes of board members across a wide cross section of ESG issues. In addition to the disclosure of the gender, racial, and ethnic diversity of the board members and candidates, it should also require disclosure of their ESG-relevant skills and expertise. The board should also be charged with explaining how it is incorporating the views of workers, communities, and other major stakeholders, including both retail and long-term investors, in the corporation's governance, as well as how it is achieving its long-term-oriented goals. The SEC should explore ways to promote best practices on board attention to ESG-related matters and stakeholders—including, as noted above, with respect to audit committee oversight.

Such a proposal, in part, would not be so different from the direction the United Kingdom is going in its corporate governance code. Following a spate of corporate scandals in the last year, the United Kingdom's revised corporate governance code, effective January 2019, directs boards to explain their approach to the long-term interests of the company as mandated in the code.[190] Other U.K. actions underway may include the implementation of parliamentary and regulatory recommendations calling for companies to appoint more diverse boards, including workers, and to convene stakeholder advisory councils.[191]

It's worth noting that the shareholder proposal process under Rule 14a-8, described above, has long been a useful tool to get management and boards to focus on long-termism and ESG matters, in particular from a risk management perspective. The SEC issued a staff bulletin in 2017 that increases board involvement in the process. Thus, when a board requests the SEC to permit the company to exclude a proposal from the proxy, the board must explain its views on the matter. Boards will have to be attentive to the range of long-term-oriented proposals that ESG-oriented shareholders put forward and maintain policies, procedures, and processes for thinking through them appropriately.[192] This should be a priority for SEC engagement with companies and, as appropriate, enforcement. At the same time, it highlights the importance of countering the series of one-sided attacks on shareholder voice, discussed below, on the ability of investors to offer Rule 14a-8 proposals,[193] and on how and with whom investors freely choose to consult for those and other votes, which are discussed next.[194]

Boost shareholder voice in favor of ESG and long-termism

If there is one concept that unifies the diverse voices at the SEC, it is that shareholders are the core pillars of the corporation and hence the capital markets.[195] And indeed, the thesis of this paper is that shareholders bear the primary risks that insufficient ESG disclosure has created. Both federal securities law and state corporate law, of course, reserve pre-eminent roles for shareholders in the exercise of corporate governance. While much of this paper seeks to look beyond the debate about how corporate governance changes could promote corporate long-termism, it cannot completely ignore the role that shareholders play in being able to advance their own interests in ESG disclosure.

It is essential that shareholders retain robust rights to utilize shareholder proposals and to obtain the independent governance advice of their own choosing. Efforts to shut down or significantly constrain those tools would thwart the private market give-and-take between shareholders and management embodied in so-called shareholder democracy that, to date, has enabled important advances on a wide range of ESG issues—not the least of which is the "G" for governance.[196] To the extent that corporate executives feel frustrated by the time and attention they have to spend on proxy matters, they would be well-served to remember the even greater cost associated with financial and reputational losses that can be prevented by shareholder engagement.[197] Moreover, in a world that increasingly values crowdsourcing and more radical approaches to transparency, more rather than less reliance on diverse shareholder data points may well be a wiser approach to risk management and the identification of new opportunities.[198]

But shareholder voice, especially at the retail level, is today overwhelmingly mediated by the mutual funds in which more than 100 million Americans, or 45 percent of U.S. households, put their money, and the asset managers that advise those funds.[199] To that end, millions of working Americans are "forced capitalists," locked into the market in a small selection of 401(k)s or a pension fund for the long run.[200] Fortunately, asset managers are fiduciaries to their funds and, ultimately, to its investors. Asset managers, as such, are positioned to take a longer-term view. What that exactly means, though, may vary greatly. Some funds are focused on particular sectors with sustainability mandates or have become widely known to engage on ESG matters.[201] As noted above, engagement refers to where an investor works with management to address concerns, rather than selling a stock or taking some other formal action. Other asset managers do not engage on ESG matters or simply follow companies' management for important shareholder votes.[202]

This should change. In 2003, the SEC required mutual funds to disclose how they vote their proxies after the fact.[203] Now, the SEC should require mutual funds to disclose their policies and approach to ESG matters more broadly, including describing how they approach voting and engagement.[204] Moreover, any mutual fund handling long-term investments, such as college savings or retirement funds, should disclose how their voting and engagement are calibrated toward the long-term horizons of their owners.[205] Similar attention should also be paid to whether boosting ESG disclosure could support greater long-term orientation for private funds—hedge funds and private equity funds.

The SEC should also explore ways to better align asset managers' proxy votes with the views of their underlying mutual fund investors that desire greater long-termism. One tool may be to address the problem of abstentions being counted as votes against an ESG resolution.[206] Another option may be to provide mutual fund investors with greater choice in having their asset manager vote a proportional amount of the funds' proxies along ESG lines.[207]

Broadly speaking, an increasing amount of attention is being paid to the impact that asset managers, especially index funds, are having on companies, their governance, and broader impacts. Some scholars have questioned the ability and incentives of asset managers to fully and properly conduct engagement initiatives across the public markets.[208] Others disagree and point to how index funds, through engagement and other means, compete meaningfully with actively managed funds.[209] In a separate debate, some have highlighted the correlation—although not yet causation—between index fund ownership and monopoly power in concentrated sectors.[210] The point relevant here is that long-term oriented engagement by asset managers with substantial shareholder heft is a welcome addition to the markets and to corporate governance generally—and should be encouraged.[211]

Ultimately, shareholder voice and engagement are still concepts and practices in flux, and SEC Chairman Clayton is right to highlight the range of real policy tensions that exist in these areas and to convene a roundtable to explore these questions, among others.[212]

Conclusion

From worker training to climate change-related information and beyond, insufficient transparency in the capital markets is failing investors, companies, and the public's long-term interests. As environmental, social, and governance (ESG) issues continue to have more frequent and significant impacts on businesses, the economy, and society, it becomes imperative that the required disclosures of publicly listed companies give an honest assessment about the risks and opportunities that corporations and markets face. Ultimately, by improving the transparency, consistency, and quality of ESG information and company engagement with ESG matters overall, the SEC can better meet its mission of ensuring investors are better protected, markets are fair, capital is effectively allocated, and the public interest is served.

About the authors

Andy Green is the managing director of Economic Policy at the Center for American Progress. His research covers financial markets , competition, international trade, and the economy and middle class. Green was editor of "Raising Wages and Rebuilding Wealth: A Roadmap for Middle-Class Economic Security," a wide-ranging CAP report on causes and solutions to the wages and wealth squeeze on middle-class America.

Prior to coming to CAP, he was counsel to Commissioner Kara Stein of the U.S. Securities and Exchange Commission and to U.S. Sen. Jeff Merkley (D-OR) on the U.S. Senate Committee on Banking, Housing, and Urban Affairs. In those roles, he worked extensively on the Dodd-Frank Act's Volcker rule and on the Jobs Act's crowdfunding provisions. Green previously practiced corporate securities and holds a B.A. and an M.A. from Harvard University and a J.D. from the University of California, Hastings College of the Law.

Andrew Schwartz is a policy analyst of Economic Policy at the Center for American Progress, specializing in spatial data analysis. His interests include social and economic policy and urban issues. He has previously worked at the National Center for Freight and Infrastructure Research and Education and the Wisconsin State Legislature. He holds a master's degree from the Lyndon B. Johnson School of Public Affairs at the University of Texas at Austin, as well as a graduate certificate in geographic information systems and a bachelor's degree in agricultural and applied economics, both from the University of Wisconsin at Madison.

Acknowledgments

The authors wish to acknowledge Carl Chancellor, Gregg Gelzinis, Galen Hendricks, Irene Hong, and Shanée Simhoni for their contributions to this report, and especially Tyler Gellasch for contributing early drafting support. The authors also wish to acknowledge helpful feedback from a wide range of experts.

Endnotes

1 Marc Jarsulic, Brendan V. Duke, and Michael Madowitz, "Long-Termism or Lemons: The Role of Public Policy in Promoting Long-Term Investments" (Washington: Center for American Progress, 2015), available at https://cdn.americanprogress.org/wp-content/uploads/2015/10/21060054/LongTermism-reportB.pdf; Brendan Duke, Andrew Schwartz, and Andy Green, "5 Steps to Address Corporate America's Short-Termism Problem," Center for American Progress, September 29, 2016, available at https://www.americanprogress.org/issues/economy/news/2016/09/29/145040/5-steps-to-address-corporate-americas-short-termism-problem/.

2 Stephen J. Terry, "The Macro Impact of Short-Termism" (Cambridge, MA: Massachusetts Institute of Technology, 2015), available at http://economics.mit.edu/files/10386.

3 See, for example, Letter from Thomas P. DiNapoli to Brent J. Fields, July 21, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-205.pdf; letter from Anne Sheehan to Brent J. , July 21, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-226.pdf; letter from Henry M. Paulson, Robert E. Rubin, and George P. Shultz to Brent J. Fields, July 20, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-202.pdf; letter from Julia M. Stasch to Mary Jo White, July 20, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-234.pdf; letter from SEC Investor Advisory Committee to the Division of Corporation Finance, U.S. Securities and Exchange Commission, June 15, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-22.pdf; U.S. Securities and Exchange Commission, "Minutes of the Meeting on June 7, 2016," available at at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac060716-minutes.htm (last accessed August 2018); Tyler Gellasch, "Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release" (Washington: Public Citizen, 2016), available at https://www.citizen.org/sites/default/files/sustainableeconomyreport.pdf; letter Ceres on behalf of 45 asset owners and managers to Mary Jo White, July 20, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-174.pdf; International Corporate Accountability Roundtable, "'Knowing and Showing': Using U.S. Securities Laws to Compel Human Rights Disclosure" (2016), available at https://www.sec.gov/comments/s7-06-16/s70616-161.pdf; Lisa Gilbert and Rachel Curley, "The Historic Campaign for Corporate Political Spending Disclosure" (Washington: Public Citizen, 2016), available at https://corporatereformcoalition.org/wp-content/uploads/2016/10/Corporate-Political-Spending-Disclosure-report.pdf; letter from Jon Lukonmnik to Secretary, U.S. Securities and Exchange Commission, July 6, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-5.pdf; letter from CDP to U.S. Securities and Exchange Commission, June 22, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-29.pdf; letter from Jean Rogers to Brent J. Fields, July 1, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-25.pdf; letter from PricewaterhouseCoopers LLP to Brent J. Fields, July 21, 2016, A9, available at https://www.sec.gov/comments/s7-06-16/s70616-258.pdf; U.S. Securities and Exchange Commission, "Comments on Concept Release: Business and Financial Disclosure Required by Regulation S-K," available at https://www.sec.gov/comments/s7-06-16/s70616.htm (last accessed February 2017).

4 U.S. Securities and Exchange Commission, "What We Do," available at https://www.sec.gov/Article/whatwedo.html (last accessed August 2018).

5 See, for example, U.S. Securities and Exchange Commission, "Asset-Backed Securities Registration and Disclosure; Final Rule," *Federal Register* 79 (185) (2014): 57184, 57186, available at https://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-21375.pdf. "In the 2010 ABS Proposing Release we noted that the financial crisis highlighted that investors and other participants in the securitization market did not have the necessary information and time to be able to fully assess the risks underlying asset-backed securities and did not value asset-backed securities properly or accurately. This lack of understanding and the extent to which it impacted the U.S. and global economy prompted us to revisit several aspects of our regulation of asset-backed securities."

6 Neera Tanden and others, "Toward a Marshall Plan for America: Rebuilding Our Towns, Cities, and the Middle Class" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/reports/2017/05/16/432499/toward-marshall-plan-america/; Dani Rodrik, "Populism and the economics of globalization" (Cambridge, MA: John F. Kennedy School of Government, Harvard University, 2017), available at https://drodrik.scholar.harvard.edu/files/dani-rodrik/files/populism_and_the_economics_of_globalization.pdf; Marc Jarsulic and others, "Reviving Antitrust: Why Our Economy Needs a Progressive Competition Policy" (Washington: Center for American Progress, 2016), available at https://www.americanprogress.org/issues/economy/reports/2016/06/29/140613/reviving-antitrust/.

7 Robert Jackson Jr., "Stock Buybacks and Corporate Cashouts," U.S. Securities and Exchange Commission, June 11, 2018, available at https://www.sec.gov/news/speech/speech-jackson-061118; Carmel Martin, Andy Green, Brendan Duke, eds., "Raising Wages and Rebuilding Wealth: A Roadmap for Middle-Class Economic Security" (Washington: Center for American Progress, 2016), available at https://www.americanprogress.org/issues/economy/reports/2016/09/08/143585/raising-wages-and-rebuilding-wealth/.

8 Brian Gardner, "The Cost of Inaction: Recognizing the Value at Risk from Climate Change," (London: The Economist, 2015), available at http://perspectives.eiu.com/sustainability/cost-inaction.

9 On fads and misallocation, see Robert J. Schiller, "From Efficient Markets Theory to Behavioral Finance," *Journal of Economic Perspectives* 17 (1) (2003): 83–104, available at http://www.econ.yale.edu/~shiller/pubs/p1055.pdf; on market long-termism and systemic risk, see Bank of International Settlements, "Mark Carney: Breaking the tragedy of the horizon – climate change and financial stability," September 29, 2015, available at https://www.bis.org/review/r151009a.pdf.

10 Whether it be countries or companies, accurate data are critical to the ability to face and overcome challenges and seize opportunities. See Thomas Gryta, Joann S. Lublin, and David Benoit, "How Jeffrey Immelt's 'Success Theater' Masked the Rot at GE," *The Wall Street Journal*, February 21, 2018, available at https://www.wsj.com/articles/how-jeffrey-immelts-success-theater-masked-the-rot-at-ge-1519231067; Bethany McLean and Peter Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron* (New York: Portfolio Trade, 2003); for discussion on how false statistics were a significant contributor to famine and economic crisis during China's Great Leap Forward, see Tom Orlik, "Lies, Damned Lies, and Chinese Statistics," *Foreign Policy*, March 20, 2013, available at http://foreignpolicy.com/2013/03/20/lies-damned-lies-and-chinese-statistics/.

11 Gellasch, "Towards a Sustainable Economy"; U.S. Securities and Exchange Commission, "Comments on Concept Release."

12 Morgan Stanley Institute for Sustainable Investing, "Sustainable Value: Communicating ESG to the 21st Century Investor" (2017), available at http://www.morganstanley.com/auth/content/dam/msdotcom/ideas/investor-relations/1910712-Sustainable-Value-Communicating-ESG.pdf.

13 Letter from Pax World Management LLC to Brent J. Fields, July 19, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-152.pdf.

14 Governance and Accountability Institute Inc., "81% of S&P 500 Companies Published Corporate Sustainability Reports in 2015" (2016), available at http://www.ga-institute.com/nc/issue-master-system/news-details/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html.

15 See, for example, Gellasch, "Towards a Sustainable Economy."

16 See, for example, provisions included or proposed to be included in recent appropriations bills that limit or would limit additional disclosure requirements on political spending and climate change. Jim Spencer, "Appropriations bill would bar SEC from requiring political spending disclosure" *Star Tribune*, January 12, 2018, available at http://www.startribune.com/appropriations-bill-would-bar-sec-from-requiring-political-spending-disclosure/469039303/.

17 See, for example, Gardner, "The Cost of Inaction."

18 Jay Clayton, "Remarks at the Economic Club of New York," U.S. Securities and Exchange Commission, July 12, 2017, available at https://www.sec.gov/news/speech/remarks-economic-club-new-york.

19 See, generally, Cynthia A. Williams, "The Securities and Exchange Commission and Corporate Social Transparency," *Harvard Law Review* 12 (1999): 1197, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=169456; Roberta S. Karmel, "Disclosure Reform—The SEC is Riding Off in Two Directions at Once," *The Business Lawyer* 71 (3) (2016): 731–834, available at https://www.americanbar.org/content/aba/tools/digitalassetabstract.html/content/dam/aba/publications/business_lawyer/2016/71_3/article-disclosure-reform-201607.pdf; Elisse Walter, Tom Riesenberg, and Jean Rogers, "The SEC and the Regulation S-K Concept Release: What Financial Executives Need to Know" (San Francisco: Sustainability Accounting Standards Board, 2016), available at https://fsa.sasb.org/wp-content/uploads/2016/06/FEI-Webinar-on-SEC-Topic.pdf.

20 See William Lazonick, "Profits Without Prosperity: How Stock Buybacks Manipulate the Market, and Leave Most Americans Worse Off" (Toronto: Annual Conference of the Institute for New Economic Thinking, 2014), available at https://www.ineteconomics.org/uploads/papers/LAZONICK_William_Profits-without-Prosperity-20140406.pdf.

21 Jarsulic, Duke, and Madowitz, "Long-Termism or Lemons."

22 Ibid. See also, for example, Suzanne Berger, "How Finance Gutted Manufacturing," *Boston Review*, April 1, 2014, available at http://bostonreview.net/forum/suzanne-berger-how-finance-gutted-manufacturing; William Lazonick, "From Innovation to Financialization: How Shareholder Value Ideology is Destroying the US Economy" (Lowell, MA: University of Massachusetts, 2011), available at www.rooseveltinstitute.org/wp-content/uploads/2011/07/innovation-and-financialization.pdf; Leo E. Strine Jr., "Who Bleeds When the Wolves Bite? A Flesh-And-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System," *The Yale Law Journal* 126 (2017): 1870–1970, available at http://scholarship.law.upenn.edu/faculty_scholarship/1727.

23 Jarsulic, Duke, and Madowitz, "Long-Termism or Lemons." Insufficient competition also appears to be a similar factor. See Jarsulic and others, "Reviving Antitrust."

24 Berger, "How Finance Gutted Manufacturing"; Jarsulic and others, "Reviving Antitrust"; see also, for example, Brian Alexander, *Glass House: The 1% Economy and the Shattering of the All-American Town* (New York: St. Martin's Press, 2017).

25 See, for example, Lenore Palladino, "Stock Buybacks: Driving a High-Profit, Low-Wage Economy" (New York: Roosevelt Institute, 2018), available at http://rooseveltinstitute.org/stock-buybacks-high-profit-low-wage/; Kara M. Stein, "Toward Healthy Companies and a Stronger Economy: Remarks to the U.S. Treasury Department's Corporate Women in Finance Symposium," U.S. Securities and Exchange Commission, April 30, 2015, available at https://www.sec.gov/news/speech/stein-toward-healthy-companies.html; Mike Konczal, Amanda Page-Hoongrajok, and J.W. Mason, "Ending Short-Termism: An Investment Agenda for Growth" (New York: Roosevelt Institute, 2015), available at rooseveltinstitute.org/ending-short-termism-investment-agenda-growth/; Lazonick, "Profits Without Prosperity."

26 See, for example, Leo E. Strine Jr., "Securing Our Nation's Economic Future: A Sensible, Nonpartisan Agenda to Increase Long-Term Investment and Job Creation in the United States" (Philadelphia: University of Pennsylvania Institute for Law and Economics, 2015), available at http://ssrn.com/abstract=2700334; Leo E. Strine Jr. "Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law," *Columbia Law* Review 114 (2) (2014): 449–502, available at https://ssrn.com/abstract=2421480; Martin Lipton, "The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth" (Cologny, Switzerland: International Business Council of the World Economic Forum, 2016), available at http://www.wlrk.com/docs/thenewparadigm.pdf. See also the efforts of the Main Street Investors Coalition, the U.S. Chamber of Commerce's Center for Capital Market Competitiveness, and the Business Roundtable to reduce investor influence, which often entails reducing disclosure, hamstringing those who provide independent governance advice to investors, and limiting enforcement and other accountability. See, for example, Main Street Investors Coalition, "Reports," available at https://mainstreetinvestors.org/category/resource-center/reports/ (last accessed September 2018); Center for Capital Market Competitiveness, "Restarting the Growth Engine: A Plan to Reform America's Capital Markets" (2016), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Restarting-the-Growth-Engine-A-Plan-to-Reform-Americas-Capital-Markets.pdf?x48633; Business Roundtable, "Responsible Shareholder Engagement and Long-Term Value Creation" (2016), available at https://www.businessroundtable.org/resources/responsible-shareholder-engagement-long-term-value-creation.

27 Usman Hayat and Matt Orsagh, "Environmental, Social, and Governance Issues in Investing A Guide for Investment Professionals" (Charlottesville, VA: CFA Institute, 2015), available at https://www.cfapubs.org/doi/pdf/10.2469/ccb.v2015.n11.1.

28 Amir Amel-Zadeh and George Serafeim, "Why and How Investors Use ESG Information: Evidence from a Global Survey" (Cambridge, MA: Harvard Business School and Oxford, UK: University of Oxford Said Business School, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925310; Emiel van Duuren, Auke Plantinga, and Bert Scholtens, "ESG Integration and the Investment Management Process: Fundamental Investing Reinvented," *Journal of Business Ethics* 138 (3) (2016): 525–533, available at https://link.springer.com/article/10.1007/s10551-015-2610-8.

29 US SIF: The Forum on Sustainable and Responsible Investment, "Report on US Sustainable, Responsible and Impact Investing 2016" (2016), available at https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf.

30 Principles for Responsible Investment, "About the PRI," available at https://www.unpri.org/about (last accessed August 2018).

31 See generally, Thomas Croft and Annie Malhotra, *The Responsible Investor Handbook: Mobilizing Workers' Capital for a Sustainable World* (Austin, TX: Greenleaf Publishing, 2016).

32 Employee Benefits Security Administration, "Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments" (U.S. Department of Labor, 2015), available at https://www.federalregister.gov/articles/2015/10/26/2015-27146/interpretive-bulletin-relating-to-the-fiduciary-standard-under-erisa-in-considering-economically#h-10. See also Employee Benefits Security Administration, "Field Assistance Bulletin 2018-01," U.S. Department of Labor, April 23, 2018, available at https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01 (reaffirming use of ESG for investment-related decisions by retirement plan fiduciaries, provided by investment returns are not sacrificed for collateral social goals).

33 Gunnar Friede, Timo Busch, and Alexander Bassen, "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies," *Journal of Sustainable Finance and Investment* 5 (4) (2015): 210–233; Mark Fulton, Bruce Kahn, and Camilla Sharples, "Sustainable Investing: Establishing Long-Term Value and Performance" (New York: Deutsche Bank and Columbia University, 2012), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2222740; Mercer, "Shedding light on responsible investment: Approaches, returns and impacts" (2009), available at http://www.sustainablefinance.ch/upload/cms/user/Shedding_light_on_responsible_investment_free_version.pdf; Michael Lee-Chin Family Institute for Corporate Citizenship, "Academic Literature on ESG and Financial Performance: Preliminary Literature Search" (2016), available at https://www.rotman.utoronto.ca/-/media/Files/Programs-and-Areas/lee-Chin_Institute/LCI-Brief--Academic-Literature-on-ESG-and-Financial-Performance-2016.pdf?la=en.

34 Fulton, Kahn, and Sharples, "Sustainable Investing"; Robert G. Eccles, Ioannis Ioannou, and George Serafeim, "The Impact of Corporate Sustainability on Corporate Behavior and Performance." Working Paper 17950 (National Bureau of Economic Research, 2012), available at http://www.nber.org/papers/w17950; see references in Amel-Zadeh and Serafeim, "Why and How Investors Use ESG Information"; Hiroshi Miyai and Yasuyuki Sugiura, "Environmental, Social, and Governance Investment and Material Disclosure by Companies" (Washington: Nikko Research Center Inc., 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3109050.

35 Paul A. Griffin and Yuan Sun, "Going Green: Market Reaction to CSR Newswire Releases" (Davis, CA: University of California, Davis, and Berkeley, CA: University of California, Berkeley, 2012), available at http://gsm.ucdavis.edu/sites/main/files/file-attachments/ssrn-id1995132.pdf.

36 Mozaffar Khan, George Serafeim, and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality," *The Accounting Review* 91 (6) (2016), available at http://aaajournals.org/doi/10.2308/accr-51383.

37 Governance and Accountability Institute Inc., "85% of the S&P 500 Index Companies Publish Sustainability Reports in 2017" (2018), available at https://www.ga-institute.com/press-releases/article/flash-report-82-of-the-sp-500-companies-published-corporate-sustainability-reports-in-2016.html.

38 According to CDP, more than 1,000 companies revealed in 2015 that they use an internal carbon price or plan to adopt this practice in the near term. See Pilita Clark, "Companies accelerate use of carbon pricing," *Financial Times*, September 21, 2015, available at http://www.ft.com/cms/s/0/7ed70bc6-5e33-11e5-a28b-50226830d644.html#axzz4JOR6iG5G.

39 Jim Coburn and Jackie Cook, "Cool Response: The SEC and Corporate Climate Change Reporting" (Boston: Ceres, 2014), available at http://www.ourenergypolicy.org/wp-content/uploads/2014/11/Ceres_SECguidance-append_020414_web.pdf.

40 Sustainability Accounting Standards Board, "Climate Risk Technical Bulletin" (2016), available at https://library.sasb.org/climate-risk-technical-bulletin/.

41 Ibid.

42 Ibid.

43 Gellasch, "Towards a Sustainable Economy," footnote 4; see also, for example, Nicholas Bloom, Raffaella Sadun, Daniela Scur, and John Van Reenen, "Helping Firms by Helping Employees? Work-Life Balance in America" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/reports/2015/12/18/127792/helping-firms-by-helping-employees/; Credit Suisse Research Institute, "The CS Gender 3000: The Reward for Change" (2016), available at https://glg.it/assets/docs/csri-gender-3000.pdf; Financial Accountability and Corporate Transparency Coalition, "A Taxing Problem for Investors: Shareholders Increasingly at Risk from Lack of Disclosure of Corporate Tax Practices" (2016), available at https://thefactcoalition.org/taxing-problem-investors-shareholders-increasingly-risk-lack-disclosure-corporate-tax-practices; Michael Brush, "Now there's a way to invest and save democracy at the same time," MarketWatch, March 6, 2017, available at https://www.marketwatch.com/story/now-theres-a-way-to-invest-and-save-democracy-at-the-same-time-2017-03-06; Bruce Freed and Karl J. Sandstrom, "Dangerous Terrain: How to Manage Corporate Political Spending in a Risky New Environment" (New York: Conference Board Review, 2012), available at http://files.cfpa.gethifi.com/reports/cpa-reports/Dangerous_Terrain.pdf; International Corporate Accountability Roundtable, "'Knowing and Showing'"; Letter from Andy Green and Gregg Gelzinis to Brent J. Fields, July 7, 2017, available at https://www.sec.gov/comments/s7-02-17/s70217-1840087-154953.pdf; and, generally, US SIF: The Forum on Sustainable and Responsible Investment, "The Impact of Sustainable and Responsible Investment" (2016), available at https://www.ussif.org/files/Publications/USSIF_ImpactofSRI_FINAL.pdf.

44 Tanden and others, "Toward a Marshall Plan for America"; Martin, Green, Duke, eds., "Raising Wages and Rebuilding Wealth".

45 Center for American Progress, "Blueprint for the 21st Century: A Plan for Better Jobs and Stronger Communities" (2018), pp. 3, 7, footnote 184, available at https://www.americanprogress.org/issues/economy/reports/2018/05/14/450856/blueprint-21st-century/; see also Tanden and others, "Toward a Marshall Plan for America," p. 13.

46 Martin, Green, Duke, eds., "Raising Wages and Rebuilding Wealth."

47 Brendan Duke and Andrew Schwartz, "The Great Midwestern Recession of 2001 and the Destruction of Good Jobs" (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/reports/2017/06/07/429492/midwestern-great-recession-2001-destruction-good-jobs/.

48 Hanks and others, "Workers or Waste?"

49 Jarsulic and others, "Long-Termism or Lemons."

50 Hanks and others, "Workers or Waste?"; Lawrence H. Summers and Ed Balls, "Report of the Commission on Inclusive Prosperity" (Washington: Center for American Progress, 2015), available at https://cdn.americanprogress.org/wp-content/uploads/2015/01/IPC-PDF-full.pdf.

51 Ibid.

52 Hanks and others, "Workers or Waste?", citing study by Bank of England chief economist Andrew Haldane that finds a 5 percent to 10 percent excessive discount on future earnings.

53 Financial Accounting Standards Board, "Statement of Financial Accounting Standards No. 2: Accounting for Research and Development Costs" (1974), available at https://www.fasb.org/resources/ccurl/286/565/fas2.pdf.

54 Ibid.

55 Kathleen M. Kahle and René M. Stulz, "Is the U.S. Public Corporation in Trouble?", *Journal of Economic Perspectives* (2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2869301.

56 Letter from Meredith Miller to William Hinman, July 6, 2017, available at https://www.sec.gov/rules/petitions/2017/petn4-711.pdf.

57 See Tanden and others, "Toward a Marshall Plan for America"; Martin, Green, Duke, eds., "Raising Wages and Rebuilding Wealth."

58 Bank of International Settlements, "Mark Carney"; Task Force on Climate-Related Financial Disclosures, "Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures" (2017), pp. 5–10, available at https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf.

59 Task Force on Climate-Related Financial Disclosures, "Phase I Report of the Task Force on Climate-Related Financial Disclosures" (2016), p. 3, available at https://www.fsb-tcfd.org/wp-content/uploads/2016/03/Phase_I_Report_v15.pdf.

60 Gardner, "The Cost of Inaction."

61 Ibid.; for a similar analysis, see also Simon Dietz and others, "'Climate Value of Risk' of Global Financial Assets," *Nature Climate Change* 6 (2016): 676–679, available at http://www.nature.com/nclimate/journal/vaop/ncurrent/full/nclimate2972.html; see also Alison Cassady and Gwynne Taraska, "Proxy Carbon Pricing: A Tool for Fiscally Rational and Climate-Compatible Governance" (Washington: Center for American Progress, 2016), available at https://www.americanprogress.org/issues/green/report/2016/04/18/135580/proxy-carbon-pricing/; Gwynne Taraska and Henry Kellison, "Could the G-20 Become Coherent on Climate? Reconciling the Priorities on Climate and Infrastructure from Hangzhou to Hamburg" (Washington: Center for American Progress, 2016), https://www.americanprogress.org/issues/green/report/2016/08/25/143032/could-the-g-20-become-coherent-on-climate/.

62 Ibid.

63 Ibid.

64 Asset Owners Disclosure Project, "Global Climate Index 2013-14" (2013), available at http://aodproject.net/wp-content/uploads/2013/12/AODP-GLOBAL-CLIMATE-INDEX-2013-14-PRINT.pdf.

65 Sustainable Accounting Standards Board, "Climate Risk Technical Bulletin."

66 See Lisa Woll, "Reflections from a Field Builder: The Next 25 Years of Sustainable, Responsible and Impact Investing," GreenMoney, September/October 2017, available at https://www.ussif.org/files/Article/Reflections%20from%20a%20field%20builder.pdf.

67 Bank of International Settlements, "Mark Carney."

68 See *Securities Exchange Act of 1934*, Public Law 73-291, 73rd Cong., 2d sess. (June 6, 2934), 2, available at https://www.sec.gov/about/laws/sea34.pdf.

69 See, generally, Asset Owners Disclosure Project, "Global Climate Index 2017: Rating the World's Investors on Climate Related Financial Risk" (2017), available at https://aodproject.net/wp-content/uploads/2017/04/AODP-GLOBAL-INDEX-REPORT-2017_FINAL_VIEW.pdf; Asset Owners Disclosure Project, "Winning Climate Strategies: Practical Solutions and Building Blocks for Asset Owners from Beginner to Best Practice" (2018), available at https://aodproject.net/wp-content/uploads/2018/06/AODP-WinningStrategiesReport.pdf.

70 *Natural Resources Defense Council Inc. v. Securities and Exchange Commission*, 606 F.2d 1031 (D.C. Cir. 1979), available at https://law.justia.com/cases/federal/appellate-courts/F2/606/1031/441395/; see also Williams, "The Securities and Exchange Commission and Corporate Social Transparency," pp. 1197–1311.

71 *Natural Resources Defense Council Inc. v. Securities and Exchange Commission*.

72 Ibid.

73 Gellasch, "Towards a Sustainable Economy"; U.S. Securities and Exchange Commission, "Comments on Concept Release."

74 Ibid.

75 Gilbert and Curley, "The Historic Campaign for Corporate Political Spending Disclosure."

76 In general, the Securities Act of 1933 sets forth the information that must be disclosed in the public offering of securities, while the Securities Exchange Act of 1934 sets forth ongoing reporting requirements for publicly held companies. The SEC unified these disclosure regimes in its 1982 reforms. See *Securities Act of 1933*, Public Law 73–22, 73rd Cong., 1 sess. (May 27, 1933), available at http://legcounsel.house.gov/Comps/Securities%20Act%20Of%201933.pdf; *Securities Exchange Act of 1934*.

77 17 C.F.R. § 229 (2016), available at http://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:3.0.1.1.11&rgn=div5.

78 See James D. Cox and Randall S. Thomas, "Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law," *European Company and Financial Law Review* 164 (2009), available at https://ssrn.com/abstract=1370508.

79 17 C.F.R. § 229 (2016); Staff of the U.S. Securities and Exchange Commission, "Report on Review of Disclosure Requirements in Regulation S-K" (2013), p. 8, available at https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

80 Ibid.

81 Ibid.

82 17 C.F.R. 229.101(c)(vii), available at https://www.law.cornell.edu/cfr/text/17/229.101.

83 17 C.F.R. 229.103, available at https://www.law.cornell.edu/cfr/text/17/229.103.

84 Ibid, Instructions to Item 103, para. 5.

85 U.S. Securities and Exchange Commission, "Commission Guidance Regarding Disclosure Related to Climate Change" (2010), available at https://www.sec.gov/rules/interp/2010/33-9106.pdf; citing speech by Commissioner Cynthia A. Glassman to the Corporate Counsel Institute. See Cynthia A. Glassman, "Speech by SEC Commissioner: Remarks before the Tenth Annual Corporate Counsel Institute, Priorities and Concerns at the SEC," U.S. Securities and Exchange Commission, March 9, 2006, available at www.sec.gov/news/speech/spch030906cag.htm; Elisse B. Walter, "SEC Rulemaking — 'Advancing the Law' to Protect Investors," U.S. Securities and Exchange Commission, October 2, 2009, available at www.sec.gov/news/speech/2009/spch100209ebw.htm.

86 17 C.F.R. 229.503, available at https://www.law.cornell.edu/cfr/text/17/229.503.

87 See, for example, John W. White, "The Principles Matter: Options Disclosure," U.S. Securities and Exchange Commission, September 11, 2006, available at https://www.sec.gov/news/speech/2006/spch091106jww.htm ("Principles, in my view, are an important thread running throughout the Commission's recent rulemaking."); see also, U.S. Securities and Exchange Commission, "Comments on Concept Release," p. 34.

88 For a brief history of the SEC's adjustments to its 1982 disclosure framework, see U.S. Securities and Exchange Commission, "Report on Review of Disclosure Requirements in Regulation S-K" (2013), pp. 8–30, available at https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

89 California Public Employees' Retirement System and others, "Petition for Interpretative Guidance on Climate Risk Disclosure," September 17, 2007, available at https://www.sec.gov/rules/petitions/2007/petn4-547.pdf.

90 U.S. Securities and Exchange Commission, "Commission Guidance Regarding Disclosure Related to Climate Change."

91 Ibid.

92 Coburn and Cook, "Cool Response."

93 U.S. General Accountability Office, "Climate-Related Risks: SEC Has Taken Steps to Clarify Disclosure Requirements" (2018), p. 15, available at https://www.gao.gov/assets/700/690197.pdf.

94 *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Public Law 111–203, 111th Cong., 2d. sess. (July 21, 2010), 953(b), 1502-04, available at https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

95 See, for example, Dan Gallagher, "Statement at SEC Meeting: Proposed Rule to Implement Section 1502 of the Dodd-Frank Act – the 'Conflict Minerals' Provision," U.S. Securities and Exchange Commission, August 22, 2012, available at https://www.sec.gov/news/public-statement/2012-08-22-open-meeting-statement-dmg.

96 Jena McGregor, "As companies reveal gigantic CEO-to-worker pay ratios, some worry how low-paid workers might take the news," *The Washington Post*, February 21, 2018, available at https://www.washingtonpost.com/news/on-leadership/wp/2018/02/21/as-companies-reveal-gigantic-ceo-to-worker-pay-ratios-some-worry-how-low-paid-workers-might-take-the-news/.

97 See Institutional Investors, "Letter to Michael S. Piwowar, Acting Chairman, Securities and Exchange Commission, Re: Reconsideration of Pay-Ratio Rule Implementation," March 22, 2017, available at https://www.sec.gov/comments/pay-ratio-statement/cll3-1659288-148805.pdf; Letter from Brandon J. Rees to Michael S. Piwowar, March 22, 2017, available at https://www.sec.gov/comments/pay-ratio-statement/cll3-1661366-148849.pdf.

98 See *Iran Threat Reduction and Syria Human Rights Act of 2012*, Public Law 158, 112th Cong., 2d sess. (August 10, 2012); see also U.S. Securities and Exchange Commission, "Notice required by the Iran Threat Reduction and Syria Human Rights Act of 2012 to be filed through EDGAR," December 19, 2012, available at https://www.sec.gov/divisions/corpfin/cfannouncements/itr-act2012.htm.

99 Matthew J. Mallow and Jasmin Sethi, "Engagement: The Missing Middle in the Bebchuk-Strine Debate," *New York Journal of Law and Business* 12 (2) (2016), available at https://www.blackrock.com/corporate/en-is/literature/publication/mallow-sethi-engagement-missing-middle-approach-may-2016.pdf.

100 J. Robert Brown Jr., "Corporate Governance, Shareholder Proposals, and Engagement Between Managers and Owners," *Denver Law Review* 94 (2017), available at http://www.denverlawreview.org/dlr-onlinearticle/2017/5/23/corporate-governance-shareholder-proposals-and-engagement-be.html.

101 California Public Employees' Retirement System and California State Teachers' Retirement System, "The Importance of Corporate Engagement of Climate Change," available at https://www.calpers.ca.gov/docs/corporate-engagement-climate-change.pdf (last accessed August 2018).

102 Brown Jr., "Corporate Governance, Shareholder Proposals, and Engagement Between Managers and Owners."

103 See US SIF: The Forum for Sustainable and Responsible Investment, "The Impact of Sustainable and Responsible Investment."

104 Brown Jr., "Corporate Governance, Shareholder Proposals, and Engagement Between Managers and Owners."

105 Adam M. Kanzer, "The Dangerous 'Promise of Market Reform': No Shareholder Proposals," Harvard Law School Forum on Corporate Governance and Financial Regulation, June 15, 2017, available at https://corpgov.law.harvard.edu/2017/06/15/the-dangerous-promise-of-market-reform-no-shareholder-proposals/.

106 Sanford Lewis, "Analysis and Recommendations on Shareholder Proposal Decision-Making under the SEC No-Action Process," Harvard Law School Forum on Corporate Governance and Financial Regulation, July 26, 2018, available at https://corpgov.law.harvard.edu/2018/07/26/analysis-and-recommendations-on-shareholder-proposal-decision-making-under-the-sec-no-action-process/#more-109153.

107 Ceres, US SIF, and Interfaith Center on Corporate Responsibility, "The Business Case for the Current SEC Shareholder Proposal Process" (2017), available at https://www.ussif.org/files/Public_Policy/Comment_Letters/Business%20Case%20for%2014a-8.pdf.

108 Ibid.

109 Ibid; see also Robert Yablon, "Campaign Finance Without Law," *Iowa Law Review* 103 (185) (2017).

110 Proxy Preview, "Home," available at http://www.proxypreview.org/ (last accessed August 2018).

111 See Marlow and Sethi, "Engagement."

112 See American Federation of Labor and Congress of Industrial Organizations Office of Investment, "AFL-CIO Key Votes Survey: 2017 Proxy Season Investment Manager Scorecards" (2018), available at https://aflcio.org/sites/default/files/2018-02/2017%20AFL-CIO%20Investment%20Manager%20Scorecards.pdf.

113 Sustainable Stock Exchanges Initiative, "SSE campaign to close the ESG guidance gap," available at http://www.sseinitiative.org/esg-guidance/ (last accessed March 2018); see also Danielle Chesebrough, "2016 Report on Progress" (Sustainable Stock Exchanges Initiative, 2016), available at http://www.sseinitiative.org/wp-content/uploads/2012/03/SSE-Report-on-Progress-2016.pdf.

114 World Federation of Exchanges, "WFE Sustainability Working Group Exchange Guidance and Recommendations" (2015), available at http://www.sseinitiative.org/wp-content/uploads/2015/11/WFE-ESG-Recommendation-Guidance-Oct-2015.pdf; Ceres, "Investor Listing Standard Proposals: Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting," March 26, 2014, available at https://www.ceres.org/resources/reports/investor-listing-standards-proposal.

115 Sustainable Stock Exchanges Initiative, "SSE campaign to close the ESG guidance gap"; see also Chesebrough, "2016 Report on Progress."

116 LTSE, "LTSE Listings on IEX," available at http://ltse.com/listings (last accessed March 2018); Alexander Osipovich and Dennis K. Berman, "Silicon Valley Vs. Wall Street: Can the New Long-Term Stock Exchange Disrupt Capitalism?", *The Wall Street Journal*, October 16, 2017, available at https://www.wsj.com/articles/silicon-valley-vs-wall-street-can-the-new-long-term-stock-exchange-disrupt-capitalism-1508151600.

117 Some of the voluntary approaches have more enforcement capability than others. For example, Johannesburg was an early adopter of integrated reporting on a comply-or-explain basis. See Johannesburg Exchange, "Our sphere of control and influence: Setting a strong enabling framework," available at https://www.jse.co.za/about/sustainability/regulator-influencer-advocate (last accessed August 2018).

118 See Ceres, "Investors Have Their Say on Sustainability and Stock Exchanges: Feedback on the WFE ESG Guidance and Recommendations," April 3, 2017, available at https://www.ceres.org/resources/reports/investors-have-their-say-sustainability-and-stock-exchanges.

119 EUR-Lex, "Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance," available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095 (last accessed August 2018).

120 William Thomas and Annise Maguire, "Changes Ahead for Corporate Sustainability Disclosures Following Publication of New EU Directive," Willkie Farr and Gallagher LLP, December 29, 2014, available at http://www.willkie.com/~/media/Files/Publications/2014/12/Changes_Ahead_for_Corporate_Sustainability_Disclosures_Following_Publication_of_New_EU_Directive.pdf.

121 See, for example, Amy Mason and others, "French Energy Transition Law: Global Investor Briefing" (London: Principles for Responsible Investment, 2016), available at http://www.unepfi.org/fileadmin/documents/PRI-FrenchEnergyTransitionLaw.pdf.

122 EY & Boston College Center for Corporate Citizenship, "Value of sustainability reporting" (2016), p. 4, available at https://www.ey.com/Publication/vwLUAssets/EY_-_Value_of_sustainability_reporting/$FILE/EY-Value-of-Sustainability-Reporting.pdf; Donato Calace, "The battle continues: GRI vs SASB vs IR," GreenBiz, March 15, 2016, available at https://www.greenbiz.com/article/battle-continues-gri-vs-sasb-vs-ir.

123 Global Reporting Initiative, "Sustainability Disclosure Database," available at http://database.globalreporting.org/ (last accessed April 2016).

124 Ibid.

125 See John K. Lewis, "Corporate Social Responsibility/Sustainability Reporting Among the Fortune 250: Greenwashing or Green Supply Chain?" (Newport, RI: Digital Commons at Salve Regina, 2016), available at https://digitalcommons.salve.edu/cgi/viewcontent.cgi?article=1056&context=fac_staff_pub.

126 Olivier Boiral, "Sustainability reports as simulacra? A counter-account of A and A+ GRI reports," *Accounting, Auditing and Accountability Journal* 26 (7) (2013): 1036–71, available at http://www.emeraldinsight.com/doi/pdfplus/10.1108/AAAJ-04-2012-00998.

127 Eric J. Hespenheide and Dinah A. Koehler, "Disclosure of Long-Term Business Value" (Westlake, TX: Deloitte University Press, 2013), available at https://www2.deloitte.com/content/dam/insights/us/articles/disclosure-of-long-term-business-value/DUP150_Reporting_What_Matters.pdf.

128 Global Reporting Initiative and others, "Carrots and Sticks: Sustainability reporting policies worldwide – today's best practice, tomorrow's trends" (2013), available at https://www.globalreporting.org/resourcelibrary/carrots-and-sticks.pdf.

129 CDP, "CDP US Report 2017: Key Findings on Governance, ESG and the Role of Boards of Directors" (2017), available at https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/002/891/original/CDP-US-Report-2017-v2.pdf?1516110322.

130 Center for Political Accountability, "CPA-Zicklin Index," available at http://politicalaccountability.net/index (last accessed March 2018).

131 See JUST Capital, "2017 Survey Report" (2017), available at https://justcapital.com/polling/2017-survey-report/.

132 Asset Owners Disclosure Project, "Home," available at https://aodproject.net/ (last accessed August 2018).

133 See Betty Moy Huber and Michael Comstock, "ESG Reports and Ratings: What They Are, Why They Matter" (Cambridge, MA: Harvard Law School Forum on Corporate Governance and Financial Regulation, 2017), available at https://corpgov.law.harvard.edu/2017/07/27/esg-reports-and-ratings-what-they-are-why-they-matter/; but see Timothy M. Doyle, "Ratings That Don't Rate: The Subjective World of ESG Ratings Agencies" (Washington: American Council for Capital Formation, 2018), available at http://accfcorpgov.org/ratings-that-dont-rate-new-report-highlights-subjective-world-of-esg-ratings-agencies/ (calling, however, for greater standardized corporate ESG disclosure as a solution to problems identified with ESG ratings).

134 Sustainable Accounting Standards Board, "SASB Conceptual Framework" (2017), available at https://www.sasb.org/wp-content/uploads/2017/02/SASB-Conceptual-Framework.pdf.

135 Ibid.

136 Ibid.

137 International Integrated Reporting Council, "The International <IR> Framework" (2013), available at http://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf.

138 International Integrated Reporting Council, "Capitals: Background Paper for <IR>" (2013), available at https://integratedreporting.org/wp-content/uploads/2013/03/IR-Background-Paper-Capitals.pdf.

139 See Kathleen Hertz Rupley, Darrell Brown, and Scott Marshall, "Evolution of Corporate Reporting: From Stand-Alone Corporate Social Responsibility Reporting to Integrated Reporting," *Research in Accounting Regulation* 29 (2) (2017), available at https://ssrn.com/abstract=3062403.

140 Ibid.

141 U.S. Securities and Exchange Commission, "Commission Guidance Regarding Disclosure Related to Climate Change."

142 Harold K. Gordon, "Enforcement Proceedings Under New York's Martin Act," Jones Day, 2015, available at http://www.jonesday.com/files/Publication/cc6cfc9e-1517-4707-958d-8ea80d2042c2/Presentation/PublicationAttachment/9be275fc-e882-499c-9045-9a429519ab82/FebMar15_%20NYSupplement_MartinActFeature.pdf.

143 Felicity Barringer and Danny Hakim, "New York Subpoenas 5 Energy Companies," *The New York Times*, September 16, 2007, available at http://www.nytimes.com/2007/09/16/nyregion/16greenhouse.html; Chris Mooney and Dino Grandoni, "New York City sues Shell, ExxonMobil and other oil companies over climate change," *The Washington Post*, January 10, 2018, available at https://www.washingtonpost.com/news/energy-environment/wp/2018/01/10/new-york-city-sues-shell-exxonmobil-and-other-oil-majors-over-climate-change/?utm_term=.a6fe4a6de9aa.

144 Timothy Cama, "Financial watchdog ends Exxon accounting probe without taking action," *The Hill*, August 3 2018, available at http://thehill.com/policy/energy-environment/400293-financial-watchdog-closes-exxon-accounting-probe.

145 Sara K. Orr and Bart J. Kempf, "Voluntary Sustainability Disclosure and Emerging Litigation," *Climate Change, Sustainable Development, and Ecosystems Committee Newsletter* 19 (1) (2015), available at https://www.lw.com/thoughtLeadership/voluntary-sustainability-disclosure-and-emerging-litigation.

146 Gellasch, "Towards a Sustainable Economy."

147 See Lisa Fairfax, "Making the Corporation Safe for Shareholder Democracy," *Ohio State Law Journal* 69 (53-108) (2008), available at http://ssrn.com/abstract=2161041 (showing how expanded shareholder democracy has yielded positive results for the concerns of corporate stakeholders).

148 Letter from Adam Kanzer to Brent J. Fields, July 21, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-221.pdf.

149 Letter from J. Robert Brown to the Brent Fields, October 3, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-374.pdf; see also Jill E. Fisch, "Making Sustainability Disclosure Sustainable" (Philadelphia: University of Pennsylvania Institute of Law and Economics, 2018), available at https://ssrn.com/abstract=3233053 (exploring a new "sustainability discussion and analysis" mandate).

150 On the growing trend of data-intensive businesses, see Commissioner Kara M. Stein, U.S. Securities and Exchange Commission, "From the Data Rush to the Data Wars: A Data Revolution in Financial Markets," September 27, 2018, available at https://www.sec.gov/news/speech/speech-stein-092718; see also generally Erik F. Gerding, "Disclosure 2.0: Can Technology Solve Overload, Complexity, and Other Information Failures?", *Tulane Law Review* 90 (5) (2016), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2889598.

151 Such an approach may also be appropriate for certain other disclosure, trading, and general investor protection mandates as well.

152 See Elisabeth De Fontenay, "The Deregulation of Private Capital and the Decline of the Public Company," *Hastings Law Journal* 68 (445) (2017), available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=6431&context=faculty_scholarship.

153 See Jay Clayton, "Remarks on Capital Formation at the Nashville 36|86 Entrepreneurship Festival," U.S. Securities and Exchange Commission, August 29, 2018, available at https://www.sec.gov/news/speech/speech-clayton-082918.

154 See *Securities Act of 1933*, Section 19(b), 15 USC 77s; Robert K. Herdman, "Testimony Concerning The Roles of the SEC and the FASB in Establishing GAAP," Testimony before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, May 14, 2002, available at https://www.sec.gov/news/testimony/051402tsrkh.htm.

155 See *Sarbanes-Oxley Act of 2002*, Section 108, 15 USC 7281.

156 Committee of Sponsoring Organizations of the Treadway Commission, "Home," available at https://www.coso.org/Pages/default.aspx (last accessed March 2018).

157 U.S. Securities and Exchange Commission, "Final Rule: Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports," available at https://www.sec.gov/rules/final/33-8238.htm (last accessed August 2018).

158 Sustainable Accounting Standards Board, "SASB Conceptual Framework."

159 Karthik Ramanna, *Political Standards: Corporate Interest, Ideology, and Leadership in the Shaping of Accounting Rules for the Market Economy* (Chicago: University of Chicago Press, 2015).

160 The SASB took important steps to clarify accountability for its standards and address concerns that its previous processes gave undue influence to those issuers and professional service firms. See Sustainable Accounting Standards Board, "SASB Rules of Procedure" (2017), available at https://www.sasb.org/wp-content/uploads/2017/02/SASB-Rules-of-Procedure.pdf.

161 See Financial Accounting Foundation, "= FAF, FASB, and GASB: How We're Funded," available at http://www.accountingfoundation.org/jsp/Foundation/Page/FAFSectionPage&cid=1351027545591 (last accessed February 2018).

162 Sections 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77g(a)(10, 77j; and 77s(a)); and Sections 3(b), 12, 13, 14, 15(d), and 23(a) of the Exchange Act [15 U.S.C. 78c(b), 78l, 78m(a), 78n(a), 78o(d), and 78w(a)], cited by U.S. Securities and Exchange Commission, "Comments on Concept Release," p. 23 ("The Securities Act and the Exchange Act authorize the Commission to promulgate rules for registrant disclosure as necessary or appropriate in the public interest or for the protection of investors. The Commission has used this authority to require disclosure of information it believes is important to investors in both registration statements for public offerings and in ongoing reports."); see also Williams, "The Securities and Exchange Commission and Corporate Social Transparency."

163 Management has an important role to play, especially via the MD&A, to share its views on what is important to the company, but to rely on management's judgment for the entirety of disclosure would be to turn the process of investor due diligence, for which public disclosure is the substitute for direct investigation, on an investment on its head.

164 For example, a proposal from the Financial Accounting Standards Board, which operates under the oversight of the SEC, to add materiality finding requirement to the notes to the financial statements as recently as 2015, a move that provoked a sharp rebuke from the SEC's Investor Advisory Committee. Financial Accounting Standards Board, "FASB Proposals Improvements to Materiality to Make Financial Statement Disclosures More Effective," Press release, September 24, 2015, available at http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176166401832; SEC Investor Advisory Committee, "Re: Proposed Amendments to Statement of Financial Accounting Concepts and Notes to Financial Statements," available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-letter-fasb-materiality-012116.pdf (last accessed August 2018); see also minutes and webcast for October 15, 2015, meeting and minutes for January 21, 2016, meeting. See U.S. Securities and Exchange Commission, "Investor Advisory Committee – Archival Materials," available at https://www.sec.gov/spotlight/investor-advisory-committee-2012-archive.shtml (last accessed August 2018).

165 See *Securities and Exchange Act of 1934*, Section 10(b) as amended, 15 U.S. Code § 78j; Exchange Act Rule 10b-5, 17 C.F.R. 240.10b-5 (1951); case law including *TSC Indus. Inv. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). See also Securities and Exchange Commission, "SEC Staff Accounting Bulletin: No. 99 – Materiality," August 12, 1999, available at https://www.sec.gov/interps/account/sab99.htm (finding that information is material and must be disclosed to investors through the financial statements it files with the SEC "if there is a substantial likelihood that a reasonable person would consider it important.").

166 U.S. Government Accountability Office, "Climate-Related Risks," pp. 16–17.

167 But see letter from Sullivan and Cromwell LLP to Brent J. Fields, August 9, 2016, available at https://www.sec.gov/comments/s7-06-16/s70616-354.pdf, which presents a troublingly narrow view of "materiality" as being a purely economic concept.

168 *Securities and Exchange Act of 1934*, Section 10(b) as amended, 15 U.S. Code § 78j; Exchange Act Rule 10b-5, 17 C.F.R. 240.10b-5 (1951); case law including *TSC Indus. Inv. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). See also U.S. Securities and Exchange Commission, "SEC Staff Accounting Bulletin: No. 99 – Materiality," August 12, 1999, available at https://www.sec.gov/interps/account/sab99.htm (finding that information is material and must be disclosed to investors through the financial statements it files with the SEC "if there is a substantial likelihood that a reasonable person would consider it important.")

169 Gilbert and Curley, "The Historic Campaign for Corporate Political Spending Disclosure"; see also U.S. Securities and Exchange Commission, "Comments on Rulemaking Petition: Petition to require public companies to disclose to shareholders the use of corporate resources for political activities," available at https://www.sec.gov/comments/4-637/4-637.shtml (last accessed August 2018).

170 Yablon, "Campaign Finance Reform Without Law."

171 Alex Tausanovitch and Liz Kennedy, "How Corporate Donors Get Their Tax Breaks and 5 Ways to Fight Back," (Washington: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/democracy/reports/2017/11/30/443490/corporate-donors-get-tax-breaks-5-ways-fight-back/.

172 Lucian Bebchuk and Robert J. Jackson Jr., "Responding to Objections to Shining Light on Corporate Political Spending (1): The Claim of Immateriality," Harvard Law School Forum on Corporate Governance and Financial Regulation, April 4, 2013, available at https://corpgov.law.harvard.edu/2013/04/04/responding-to-objections-to-shining-light-on-corporate-political-spending-1-the-claim-of-immateriality/; Lucian A. Bebchuk and Robert J. Jackson Jr., "Shining Light on Corporate Political Spending," *Georgetown Law Journal* 101 (2013): 923–967, available at https://ssrn.com/abstract=2142115.

173 See Rana Foroohar, "The backlash against shareholder value," *Financial Times*, March 5, 2018, available at https://www.ft.com/content/483a6122-1e33-11e8-aaca-4574d7dabfb6.

174 See Public Company Accounting Oversight Board, "Attestation," available at https://pcaobus.org/Standards/Attestation/Pages/default.aspx (last accessed August 2016).

175 See, for example, Securities and Exchange Commission, "Possible Revisions to Audit Committee Disclosures," available at https://www.sec.gov/rules/concept/2015/33-9862.pdf (last accessed August 2018).

176 As urged by the SEC's Investor Advisory Committee, embedded structured data should be part of all filings. See U.S. Securities and Exchange Commission, "Recommendations of the Investor Advisory Committee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors (Adopted July 25, 2013)," available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/data-tagging-resolution-72513.pdf (last accessed August 2018).

177 U.S. Securities and Exchange Commission, "Inline XBRL Filing of Tagged Data," *Federal Register*, August 16, 2018," available at https://www.federalregister.gov/documents/2018/08/16/2018-14365/inline-xbrl-filing-of-tagged-data.

178 See also Gerding, "Disclosure 2.0."

179 Clayton, "Remarks at the Economic Club of New York."

180 Coburn and Cook, "Cool Response"; U.S. Government Accountability Office, "Climate-Related Risks."

181 Andy Green, "Could the SEC secretly abolish investors' right to sue?", MarketWatch, March 2, 2018, available at https://www.marketwatch.com/story/could-the-sec-secretly-abolish-investors-right-to-sue-2018-03-02.

182 See Megan L. Brown, Richard W. Smith, "Brief of Amici Curiae National Association Of Manufacturers and Chamber Of Commerce of the United States of America In Support of Plaintiff-Appellant" (Washington: National Association of Manufacturers, 2018), available at http://www.nam.org/uploadedFiles/NAM/Site_Content/Advocacy/The-Center-for-Legal-Action/Briefs-On-line/2018/ExxonMobil%20v.%20Healey%202nd%20Cir%2008102018.pdf.

183 Lipton, "The New Paradigm;" see also Investor Stewardship Group, "About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance," available at https://isgframework.org/ (last accessed August 2018); for an alternative view of corporate governance but one that reaches largely the same conclusions regarding the importance of boards of directors for corporate performance, see, e.g. Lucian A. Bebchuk and Scott Hirst, "Private Ordering and the Proxy Access Debate," Harvard John M. Olin Center for Law, Economics and Business, Discussion Paper No. 653, Revised January 2010, available at http://papers.ssrn.com/abstract =1513408.

184 Eugene C.M. Cheng and Stephen M. Courtenay, "Board Composition, Regulatory Regime, and Voluntary Disclosure," *International Journal of Accounting* 41 (3) (2006), summarized for CFA Institute, available at https://www.cfapubs.org/doi/pdf/10.2469/dig.v37.n1.4482.

185 Jeffrey N. Gordon, "The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices," *Stanford Law Review* 59 (2007): 1465, available at https://ssrn.com/abstract=928100.

186 Letter from Anne Simpson and others to Elizabeth M. Murphy, March 31, 2015, available at https://www.sec.gov/rules/petitions/2015/petn4-682.pdf.

187 See *Cybersecurity Disclosure Act of 2017*, S.536, 115th Cong., available at https://www.congress.gov/115/bills/s536/BILLS-115s536is.pdf.

188 Elizabeth Warren, "Companies Shouldn't Be Accountable Only to Shareholders," *Wall Street Journal*, August 14, 2018, available at https://www.wsj.com/articles/companies-shouldnt-be-accountable-only-to-shareholders-1534287687; see also Office of Sen. Elizabeth Warren, "Warren Introduces Accountable Capitalism Act," Press release, August 15, 2018, available at https://www.warren.senate.gov/newsroom/press-releases/warren-introduces-accountable-capitalism-act.

189 Colin Mayer, "Reinventing the corporation," *Journal of the British Academy* 4 (2016): 53–77, available at http://eureka.sbs.ox.ac.uk/6107/.

190 Financial Reporting Council, "The UK Corporate Governance Code" (2018), p. 3, available at https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf; see also Institute of Directors, "Corporate governance reporting under Section 172 of the Companies Act 2006," June 15, 2018, available at https://www.iod.com/news-campaigns/gdpr/articles/corporate-governance-reporting-under-section-172-of-the-companies-act-2006.

191 U.K. Parliament, Business, Energy and Industrial Strategy Committee, "Corporate Governance inquiry – publications," available at https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2015/corporate-governance-inquiry/publications/ (last accessed August 2018).

192 This is not to say that the SEC should necessarily defer to a board determination.

193 See Kanzer, "The Dangerous 'Promise of Market Reform."

194 See, for example, Damon Silvers, "Testimony before the Senate Committee On Banking, Housing, And Urban Affairs, "Legislative Proposals To Examine Corporate Governance," June 28, 2018, available at https://www.banking.senate.gov/imo/media/doc/Silvers%20Testimony%206-28-18.pdf (discussing H.R. 4015); George W. Dent, "A Defense of Proxy Advisors," *Michigan Law Review* 1287 (2014), available at https://ssrn.com/abstract=2451240; see also Stephen Choi, Jill Fisch, and Marcel Kahan, "The Power of Proxy Advisors: Myth or Reality?", *Emory Law Journal* 59 (2010): 869, available at http://ssrn.com/abstract=1694535.

195 See, for example, Kara Stein, "'Mutualism: Reimagining the Role of Shareholders in Modern Corporate Governance' Remarks at Stanford University," U.S. Securities and Exchange Commission, February 13, 2018, available at https://www.sec.gov/news/speech/speech-stein-021318; Hester M. Peirce, "My Beef with Stakeholders: Remarks at the 17th Annual SEC Conference, Center for Corporate Reporting and Governance," U.S. Securities and Exchange Commission, September 21, 2018, available at https://www.sec.gov/news/speech/speech-peirce-092118.

196 See Fairfax, "Making the Corporation Safe for Shareholder Democracy"; Jill. E. Fisch, Asaf Hamdani, and Steven Davidoff Solomon, "Passive Investors" (Philadelphia: University of Pennsylvania Law School, 2018), 25, available at https://scholarship.law.upenn.edu/faculty_scholarship/1983/.

197 Kanzer, "The Dangerous 'Promise of Market Reform."

198 See, for example, Henry T. C. Hu, "Too Complex to Depict? Innovation, 'Pure Information,' and the SEC Disclosure Paradigm" *Texas Law Review* 90 (7) (2012), available at https://ssrn.com/abstract=2083708.

199 Investment Company Institute, "2018 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry" (2018), available at https://www.ici.org/pdf/2018_factbook.pdf; see generally Kara Stein, "Mutual Funds – the Next 75 Years," U.S. Securities and Exchange Commission, June 15, 2015, available at https://www.sec.gov/news/speech/mutual-funds-the-next-75-years-stein.html#_ftnref7.

200 Leo E. Strine Jr., "Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance" (Cambridge, MA: Harvard Law School John M. Olin Center for Law, Economics, and Business, 2007), p. 6, available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/585.pdf.

201 Larry Fink, "A Sense of Purpose," BlackRock, available at https://www.blackrock.com/corporate/en-no/investor-relations/larry-fink-ceo-letter (last accessed August 2018).

202 See, for example, As You Sow, "The 100 Most Overpaid CEOs 2018: Are Fund Managers Asleep at the Wheel?" (2018), available at https://www.asyousow.org/report/the-100-most-overpaid-ceos-2018/; American Federation of Labor and Congress of Industrial Organizations Office of Investment, "AFL-CIO Key Votes Survey."

203 U.S. Securities and Exchange Commission, "Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies," 17 CFR Parts 239, 249, 270, and 274, 68 Fed. Reg. 6564 (2003), available at https://www.gpo.gov/fdsys/pkg/FR-2003-02-07/pdf/03-2951.pdf.

204 A proposal along these lines would align with new recommendations in the United Kingdom and with private investor organizations. See U.K. Parliament, Business, Energy and Industrial Strategy Committee, "Corporate Governance inquiry – publications"; International Corporation Governance Network, "Global Stewardship Principles" (2016), available at https://www.icgn.org/sites/default/files/ICGNGlobalStewardshipPrinciples.pdf.

205 Strine Jr., "Securing Our Nation's Economic Future," p. 20. The U.S. Department of Labor would also be an appropriate locus for this policy change.

206 The SEC has made progress in recent years in reducing this challenge as a general matter. See Choi, Fisch, and Kahan, "The Power of Proxy Advisors," pp. 872–74. But more remains to be done, especially with respect to ESG—which poses a case for treatment potentially different from other areas of corporate governance. Key arguments in favor of that would be the narrowness of its scope from the corporate perspective (as opposed to, for example, questions of corporate control), combined with the potentially strong impacts on the long-term public interest outside of the corporation. See Rob Berridge, "Here's how mutual fund giants stand on climate-related shareholder proposals," GreenBiz, February 6, 2018, available at https://www.greenbiz.com/article/heres-how-mutual-fund-giants-stand-climate-related-shareholder-proposals; Cydney Posner, "Activists seek to exclude abstentions from the voting standard for shareholder proposals," Cooley, April 1, 2015, available at https://cooleypubco.com/2015/04/01/activists-seek-to-exclude-abstentions-from-the-voting-standard-for-shareholder-proposals/; Rachel Curley, "Nearly 30,000 Americans call for Vanguard to hold companies accountable for political engagement," Corporate Reform Coalition, November 21, 2017, available at https://corporatereformcoalition.org/vanguard-petition (last accessed September 2018). The U.S. Department of Labor may also need to be involved with respect to its guidance regarding voting and fiduciary duties. See Strine, "Who Bleeds When the Wolves Bite," pp. 1966–67.

207 This may be especially valuable where investors are provided only a limited array of mutual funds as part of a 401(k) plan. It could potentially be effectuated either via an internally managed ESG voting option that the fund provides appropriate disclose about or by allowing the investor to choose an external ESG ratings or vote recommendation service, subject to whatever limits the particular fund may have with respect to its strategy or other fiduciary considerations. It could also expand the possibility for investors to take somewhat divergent approaches to ESG. See Peirce, "My Beef with Stakeholders." However, as ESG increasingly is showing performance exceeding non-ESG, it may be the case the fiduciary duties actually require ESG-oriented approaches. An ESG option might then be simply about how forward-leaning the investor wishes to be. For more information on this evolving ecosystem, see BlackRock, "The Investment Stewardship Ecosystem" (2018), available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf.

208 Dorothy Lund, "The Case Against Passive Shareholder Voting," *Journal of Corporation Law* (2017), available at https://ssrn.com/abstract=2992046.

209 Fisch, Hamdani, and Davidoff Solomon "Passive Investors."

210 Eric A. Posner, Fiona M. Scott Morton, and E. Glen Weyl, "A Proposal to Limit the Anti-Competitive Power of Institutional Investors," *Antitrust Law Journal*, forthcoming (2016), available at https://ssrn.com/abstract=2872754 or http://dx.doi.org/10.2139/ssrn.2872754; José Azar, Martin C. Schmalz, and Isabel Tecu, "Anticompetitive Effects of Common Ownership," *Journal of Finance* 73 (4) (2018), available at https://ssrn.com/abstract=2427345; Einer Elhauge, "New Evidence, Proofs, and Legal Theories on Horizontal Shareholding" (Cambridge, MA: Harvard Law School, 2018), available at https://ssrn.com/abstract=3096812. But see Investment Company Institute, "Competition and Consumer Protection in the 21st Century Hearings (Project Number P181201)" (2018), available at https://www.ici.org/pdf/18_ici_common_ownership_ltr.pdf. That correlation has not yet led to meaningful conclusions about causation may be in part due to the fact that large companies retain the services of a wide range of professional services firms, sometimes themselves in concentrated markets, including investment banks, compensation advisory firms, accounting and consulting firms, and others.

211 For more on this general topic, see Anat R. Admati, "A Skeptical View of Financialized Corporate Governance," *Journal of Economic Perspectives* (2017), available at https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/jep-final.pdf.

212 Jay Clayton, "Opening Remarks to SEC-NYU Dialogue on Securities Markets #4: Shareholder Engagement," U.S. Securities and Exchange Commission, January 19, 2018, available at https://www.sec.gov/news/speech/clayton-2018-01-19.

Our Mission

The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action. Our aim is not just to change the conversation, but to change the country.

Our Values

As progressives, we believe America should be a land of boundless opportunity, where people can climb the ladder of economic mobility. We believe we owe it to future generations to protect the planet and promote peace and shared global prosperity.

And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

Our Approach

We develop new policy ideas, challenge the media to cover the issues that truly matter, and shape the national debate. With policy teams in major issue areas, American Progress can think creatively at the cross-section of traditional boundaries to develop ideas for policymakers that lead to real change. By employing an extensive communications and outreach effort that we adapt to a rapidly changing media landscape, we move our ideas aggressively in the national policy debate.

Center for American Progress

1333 H STREET, NW, 10TH FLOOR, WASHINGTON, DC 20005 • TEL: 202-682-1611 • FAX: 202-682-1867 • WWW.AMERICANPROGRESS.ORG

Ceres
Sustainability is the bottom line.

November 13, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: The Decline in Initial Public Offerings and Shareholder Proposals

Dear Chairman Clayton:

On behalf of Ceres, I appreciate the opportunity to share our views about the shareholder proposals process. Specifically, I wish to address the misperception that shareholder proposals have contributed to the decline in initial public offerings ("IPOs") over the last two decades. To the contrary, shareholder proposals have played essentially no role in that decline. Instead, a variety of other factors have contributed to this decline; factors that would not be addressed by modifying the rules governing shareholder proposals and the proxy process. Accordingly, I urge the Securities and Exchange Commission ("SEC") to maintain Rule 14a-8 (the "Rule") as is. I hope that our comments on this matter will be helpful to the SEC as it prepares for its Roundtable on the Proxy Process on November 15.

Ceres is a non-profit organization that coordinates the Ceres Investor Network on Climate Risk and Sustainability (the "Ceres Investor Network"), which consists of 161 institutional investors that collectively manage more than $25 trillion. The Ceres Investor Network advances leading investment practices, corporate engagement strategies, and policy solutions to build an equitable and sustainable global economy.

<u>The Growth of Private Capital Markets and Numerous Other Factors Have Contributed to the Decline in IPOs.</u>

IPOs Have Been in Decline for Years

The decline in IPOs is not a new phenomenon. Rather, the IPO market has been in relative decline for much of the last two decades. IPOs exploded in the 1990s as a result, in part, of the

Internet bubble. In 1991, there were 218 IPOs.[1] Five years later, that number peaked at 624,[2] a number inflated by the height of the Internet bubble. IPOs declined to 404 in 2000[3] before falling further in the following decades. From 2001 to 2016, the number of IPOs never reached 300 in a single year.[4] 2014 had 291 IPOs, the highest number since 2000; however, by 2016, there was a 62% decline.[5] Partly due to this trend, there are fewer publicly traded companies today than in the 1990s or 2000s. Three years ago, there were 4,300 publicly traded companies, down nearly 50% from 1996.[6]

2018 has seen a slight rebound in the IPO market. At the end of the third quarter, the number of IPOs this year and the amount raised is on pace to exceed 2017's totals.[7] However, 2018 will likely not compare to 2014, itself very different from the height of IPOs in the 1990s or, potentially even, the pre-Great Recession era. Nearly half of capital raised this year was raised in the private market.[8]

The Private Capital Market Has Reduced Start-ups' Reliance on IPOs

Fewer start-ups are relying on IPOs to raise large sums as well. Before 1997, more than 85% of the start-ups that raised $150 million or more did so through an IPO.[9] From 2000 to 2017, however, 64% of start-ups raising that much capital did so through an IPO.

A major factor in the long-term decline in IPOs is the significant growth in the private capital market. Since 1992, private capital investment in start-up companies that are four or more years past their first round of financing has increased by a factor of 20.[10] Venture capital funds represent a substantial portion of this increased funding, approximately 40%.[11] In 2006, venture capital funds invested $31.2 billion in private U.S. companies; by 2015, they invested $77.3 billion.[12] Venture capital funds are not just investing more money; they are investing in more companies. Over that same time period, the number of private companies receiving venture capital

---

[1] Looking behind the declining number of public companies: An analysis of trends in US capital markets, Ernst and Young (May 2017), at 5, https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf.

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] Louise Lee, *The Decline of the IPO: With fewer companies going public, corporate transparency gets murkier*, INSIGHTS, STANFORD GRADUATE SCHOOL OF BUSINESS (Apr. 12, 2018), https://www.gsb.stanford.edu/insights/decline-ipo.

[7] Yelena Dunaevsky, *2018 IPO Market is on Target to Exceed 2017*, Bloomberg, Corporate Transactions Blog (Aug. 7, 2018), https://www.bna.com/2018-ipo-market-b73014481482/.

[8] Lee, *supra* note 6.

[9] Michael Ewens and Joan Farre-Mensa, *The Evolution of the Private Equity Market and the Decline in IPOs*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Sept. 28, 2017), https://corpgov.law.harvard.edu/2017/09/28/the-evolution-of-the-private-equity-market-and-the-decline-in-ipos/

[10] Lee, *supra* note 6.

[11] *Id.*

[12] Ernst and Young, *supra* note 1, at 10.

funds increased by 47% from 2,249 to 4,244.[13] Private funds, sovereign wealth funds, hedge funds, mutual funds, and other private investors have also significantly expanded their investments in start-ups over the last decade.[14]

Legislative Reforms Have Increased Access to Private Capital

This rise in private capital has coincided with the reduced operational and regulatory barriers to accessing such capital. The widespread adoption of the Internet over the last two decades, for example, has made it easier for private capital to invest in late-stage start-ups by reducing transaction costs and the time and expense of finding suitable companies.[15]

Two legislative reforms in particular have helped improve start-up companies' access to private capital: the National Securities Market Improvement Act of 1996 ("NSMIA") and the Jumpstart Our Business Startups ("JOBS") Act of 2012. The NSMIA enabled start-ups to access private capital more easily by exempting sales of securities by private companies from states' "blue sky laws."[16] Moreover, the law facilitated a greater accumulation of private capital by increasing the maximum number of investors venture capital and private equity funds can have before registering with the SEC.[17] By doing so, the NSMIA allowed such funds to acquire additional resources necessary to increase their investments in late-stage start-ups.[18] The JOBS Act reinforced these efforts by raising the registration requirement from 500 accredited investors to 2,000, and excluding employees who receive exempt equity awards from the registration threshold.[19] Importantly, the JOBS Act also created a safe harbor for secondary private placements that are not registered with the SEC.[20] This safe harbor reduced the incentive to go public by affording private placement offerings additional protections.[21]

Founders and Private Investors Have Fewer Incentives to Seek IPOs

The growth of private capital markets has also led to founders of start-ups maintaining greater control over their companies than in the past. Finding themselves in a more advantageous financial and operational position, many founders have decided not to dilute their control by going public. Increased funding from private capital has allowed founders to maintain more equity ownership than they have had in the past.[22] Accordingly, they have more control over "exit decisions," such as whether to launch an IPO.[23] As a result, founders are using their equity stake to prevent their companies from going public. This trend is reinforced by mutual funds, which

---

[13] *Id.*

[14] Lee, *supra* note 6.

[15] Ewens and Farre-Mensa, *supra* note 7.

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.*

have become sizable sources of capital for late-stage start-up companies. These funds have shown a willingness to hold illiquid private investments.[24] Their willingness to do so has reduced the pressure on founders to go public, thereby reinforcing their natural resistance to doing so.[25]

Other Factors—Listing Costs, Litigation Costs, Mergers, and Debt Financing

The rising costs of listing, class action litigation, increasing merger and acquisition activity, and the availability of cheap debt financing are also contributing to the decline in IPOs.
There is a massive fee differential for small and large IPOs. This fee makes it difficult for small companies to afford to go public. The size of the disparity suggests that micro cap IPOs are being actively discouraged. Such companies often pay a fee of approximately 7% whereas large cap companies like Facebook only pay 1 to 1.5%.[26] As Commissioner Jackson has pointed out, micro cap companies are essentially being taxed.[27] Like other taxes, this functional tax is discouraging micro cap companies from undergoing an IPO.

Since 2012, the number and cost of class action lawsuits filed against public companies has skyrocketed. From 2012 through 2016, the average cost to settle shareholder objections to a merger increased by 53% from $2.8 million to $4.5 million.[28] During this time period, approximately 85% of mergers by public companies were challenged.[29] Last year, more federal class action securities cases were filed than in any other year and by a significant margin.[30] 2017 experienced a 52% increase over 2016, and more than a 100% increase from the average during 1996–2016.[31] The risk of litigation is very real and very expensive.

More companies are also choosing to be acquired rather than stay independent and go public. In 2016, more than 4,800 private companies were acquired, compared with about 1,950 during the IPO peak in 1996.[32] Small and micro firms are increasingly more likely to choose a merger over an IPO, a trend that has been gaining steam since the late 1990s.[33] Mergers in general have become a leading cause of delistings, but particularly for small and micro firms.[34] In fact,

[24] *Id.*
[25] *Id.*
[26] Frank Partnoy, *The Death of the IPO*, THE ATLANTIC (Nov. 2018), https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/.
[27] *Id.*
[28] *Rising Volume and Cost of Securities Class Action Lawsuits is a Growing Tax on U.S. Business, Chubb Data Reveals*, PR NEWSWIRE (July 19, 2018), https://www.prnewswire.com/news-releases/rising-volume-and-cost-of-securities-class-action-lawsuits-is-a-growing-tax-on-us-business-chubb-data-reveals-300678169.html
[29] *Id.*
[30] Securities Class Action Filings: 2017 Year in Review, Cornerstone Research https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-YIR.
[31] *Id.*
[32] Ernst and Young, *supra* note 1, at 12.
[33] What's behind the falling number of public companies? Vanguard (Nov. 2017), https://personal.vanguard.com/pdf/ISGPCA.pdf.
[34] *Id.*

according to Vanguard, "the shrinking number of publicly listed companies consists almost entirely of those [micro] securities . . . ."[35]

Finally, debt financing has been very inexpensive for much of the last two decades because of very low interest rates. Private companies have been able to issue debt rather than go public to meet their capital needs, and have chosen to do so, in part, due to the lower cost and the greater control over operations that debt financing allows.[36]

As a result of these economic, legal, technological, and regulatory trends, private assets under management grew from less than $1 trillion in 2000 to more than $5 trillion last year.[37] The economic reality is that many companies no longer need an IPO to raise capital.[38]

Shareholder Proposals Have Had a Minimal Effect on the Decline in IPOs.

Although there are numerous reasons why IPOs have declined for most of the last two decades, shareholder proposals are not one of them. Shareholder proposals do not meaningfully increase the operating costs of companies nor do they threaten management by serving as a tool for activist investors. On the contrary, shareholder proposals strengthen companies.

Shareholder Proposals Do Not Increase Costs Meaningfully

Shareholder proposals do not meaningfully increase costs for companies because, in part, few companies receive shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017.[39] In 2016, fewer than 1,000 total shareholder proposals were filed at all reporting companies in the U.S.[40] For companies that do receive shareholder proposals, these proposals raise less than marginal costs because many of them are not voted on. Only half of the proposals submitted by shareholders in 2016, for example, appeared in companies' proxies.[41] Consequently, relatively few companies—fewer than 500—held votes on issues submitted by shareholders.[42]

Importantly, only a small proportion of proposals are filed with companies that recently launched an IPO. Less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.[43] Because large companies make up a larger portion of investors' equity portfolios than small companies, larger companies are more likely to receive shareholder proposals. Unsurprisingly, S&P 500 companies received 77% of the proposals Russell 3000

---

[35] *Id.*

[36] *Id.*

[37] Partnoy, *supra* note 26.

[38] Ewens and Farre-Mensa, *supra* note 7.

[39] An Investor Response to the U.S. Chamber's Proposal to Revise SEC Rule 14a-8, Ceres, et al. (Nov. 2017), https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf.

[40] ISS Voting Analytics database.

[41] *Id.*

[42] *Id.*

[43] ISS Voting Analytics database. *See also*, Ceres, *supra* note 44.

companies received in 2017.[44] Moreover, only 3.7% of shareholder proposals in the Institutional Shareholder Services ("ISS") database were filed at companies with a market capitalization below $1 billion.[45] The largest public companies, therefore, receive the lion's share of shareholder proposals, so most companies considering an IPO would have a low likelihood, if any, to be significantly affected by the cost of shareholder proposals.

The current resubmission thresholds also minimize costs by making it difficult to resubmit a shareholder proposal. For a proposal that addresses substantially the same subject matter as another proposal that has been previously included in a company's proxy materials within the prior five (5) calendar years, the Rule allows a company to exclude the proposal for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third.[46] As a result of this high standard, resubmission of proposals receiving less than 20% support for a third or fourth time is very rare. For example, from 2010 to 2017, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years, affecting only 26 companies.[47] According to the ISS database, of the 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017, 104 proposals (22.7%) received less than 10% of the For/Against vote.[48] In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.[49] By ensuring that shareholder proposals are not resubmitted too easily, the Rule minimizes their costs.

Shareholder Proposals Are Not Abused by Activist Investors

Activist investors do not abuse shareholder proposals, so the decline in IPOs is not caused by private companies' concerns that activist investors will use shareholder proposals to disrupt operations. From 2004–2017, the Chevedden, Steiner, and McRitchie families submitted 14.5% of the 11,706 proposals filed.[50] On average, 40% of shareholders voted in support of these proposals when they went to a vote.[51] This level of support indicates that these filers provide a valuable service to fellow shareholders by promoting good corporate governance. It does not indicate that shareholder proposals discourage late-stage start-ups from engaging in an IPO for fear of the increased operational cost, and challenge to management such alleged activism raises.

Shareholder Proposals Strengthen Companies

Rather than raise costs and discourage companies from going public, shareholder proposals actually strengthen companies. Corporate managers benefit from investor input on

[44] ISS Voting Analytics database.
[45] *Id.*
[46] 17 C.F.R. § 240.14a-8(i)(12).
[47] ISS Voting Analytics database.
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*

environmental, social, and governance ("ESG") issues. The Department of Labor has recognized the importance of ESG issues commenting that:

> *To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.*[52]

Investors such as BlackRock, State Street, and more than 2,000 members of the Principles for Responsible Investment have also publicly proclaimed the importance of ESG issues to shareholder value.[53] These claims are backed by a robust set of academic research.[54,55] In fact, more than 25% of assets under management in U.S. markets are managed with some form of ESG strategy according to US SIF.[56] Clearly, ESG issues are frequently financially material. Receiving investor input on such important issues can help managers steer their companies in the right direction.

* * * * *

IPOs have been in decline for most of the last two decades, and for a variety of reasons. Shareholder proposals, however, are not a meaningful contributor to this trend. Accordingly, we do not believe revision of Rule 14a-8 is necessary at this time. The existing Rule allows institutional investors of all sizes and individual shareholders alike to engage corporate boards and senior management on their need to address important ESG issues and long-term risk management. The current process also allows investors to communicate with boards, management, and other shareholders about the most effective, proactive way to protect investor interests with respect to corporate governance, risk, and policy issues affecting companies prior to a crisis. The current process does not and has not, on the other hand, contributed to the decline in IPOs over the last two decades.

As such, the existing process serves an important self-regulatory function for U.S. capital markets, allowing shareholders a means to protect their interests through a form of shareholder democracy.

---

[52] Field Assistance Bulletin No. 2018-01, Employee Benefits Security Administration, Department of Labor, https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.

[53] Robin Berridge, *Four Mutual Fund Giants Begin to Address Climate Change Risks in Proxy Votes: How about Your Funds?* Ceres (Dec. 21, 2017), https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about.

[54] See the studies cited: Moskowitz Past Winners, Berkeley Haas, https://responsiblebusiness.haas.berkeley.edu/research/moskowitz-past-winners.html.

[55] Performance & SRI, The Forum for Sustainable and Responsible Investment, https://www.ussif.org/performance.

[56] Report on US Sustainable, Responsible and Impact Investing Trends 2018, The Forum for Sustainable and Responsible Investment, https://www.ussif.org/files/2018%20_Trends_OnePager_Overview(4).pdf.

Thank you for considering these views. I welcome the opportunity to work with you to address these concerns. Please do not hesitate to contact me if you have any questions.

Sincerely,

Mindy S. Lubber

Mindy S. Lubber
CEO and President
Ceres

Cc: Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Peirce
Commissioner Kara M. Stein
Commissioner Elad L. Roisman

Council of Institutional Investors®
The voice of corporate governance

Via Hand Delivery

December 5, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: December 6, 2018 hearing entitled "Proxy Process and Rules: Examining Current Practices and Potential Changes"[1]

Dear Mr. Chairman and Ranking Member Brown:

I am writing on behalf of the Council of Institutional Investors (CII), a nonpartisan, nonprofit association of public, corporate, and union employee benefit funds, other employee benefit plans, foundations, and endowments with combined assets under management exceeding $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families.

Our associate members include a range of asset managers with more than $25 trillion in assets under management, most also with long-term investment horizons. CII members share a commitment to healthy public capital markets and strong corporate governance.[2]

The purpose of this letter is to thank you for holding the above referenced hearing and to share with you a summary of our views on the three issues that we understand are likely to be discussed at the hearing and are of particular interest to our members. We would respectfully request that this letter be included in the hearing record.

[1] United States Senate Committee on Banking, Housing, and Urban Affairs, Hearings, Full Committee Hearing, Proxy Process and Rules: Examining Current Practices and Potential Changes, https://www.banking.senate.gov/hearings/proxy-process-and-rules-examining-current-practices-and-potential-changes.

[2] For more information about the Council of Institutional Investors (CII) and our members, please visit CII's website at http://www.cii.org/about_us. We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), are non-voting associate members of CII, paying an aggregate of $24,000 in annual dues—less than 1.0 percent of CII's membership revenues. In addition, CII is a client of ISS, paying approximately $19,600 annually to ISS for its proxy research.

1717 Pennsylvania Avenue, NW | Suite 350 | Washington, DC 20006 | Main 202.822.0800 | Fax 202.822.0801 | www.cii.org

1. The role of proxy advisory firms

Many CII members and other institutional investors voluntarily contract with proxy advisory firms to obtain cost-effective independent research to help inform their proxy voting and engagement decisions, and to execute votes based on the funds' own proxy voting guidelines.[3] The United States (U.S.) Securities and Exchange Commission (SEC) has long recognized that proxy research firms "serve an important role in the shareowner voting process."[4]

We believe proxy voting is a critical means by which shareowners hold corporate executives and boards to account and is a hallmark of ownership and accountability. The system of corporate governance in the U.S. relies on the accountability of corporate officers and boards of directors alike to shareowners, and ensuring unencumbered shareowner access to independent research is a crucial underpinning of effective corporate governance.[5]

While many large institutional investors rely on proxy advisors to help them manage the analysis of myriad issues presented in the proxy statements accompanying thousands of shareowner meetings annually,[6] and to help administer proxy voting, these services do not constitute an abdication of responsibility for their own voting decisions.[7]

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. For example, although Institutional Shareholder Services Inc. (ISS), the largest proxy research firm, recommended voting against

---

[3] *See* Letter from Aeisha Mastagni, Interim Co-Director of Corporate Governance, California State Teachers' Retirement System to Brent J. Fields, Secretary, Securities and Exchange Commission 3 (Nov. 30, 2018) ("CalSTRS voluntarily contracts with proxy advisory firms to obtain cost-effective independent research to help inform our proxy voting and engagement decisions, and to execute votes based on our own proxy voting guidelines."), https://www.sec.gov/comments/4-725/4725-4715668-176690.pdf; Letter from Thomas P. DiNapoli, State Comptroller, State of New York, Office of the State Comptroller to Jay Clayton, U.S. Securities and Exchange Commission 4 (Nov. 13, 2018) ("While the Fund and many other investors vote their shares based on their own independent voting guidelines, these firms provide independent research, analysis and advice for institutional shareowners, which often hold thousands of companies in their investment portfolios."), https://www.sec.gov/comments/4-725/4725-4646620-176466.pdf; Letter from Jonathan Grabel, Chief Investment Officer, LACERA to Mr. Brent Fields, Secretary, Securities and Exchange Commission 3 (Oct. 30, 2018) ("LACERA votes proxies according to its *Corporate Governance Principles.*"), https://www.sec.gov/comments/4-725/4725-4587744-176291.pdf.

[4] *See, e.g.*, Commissioner Robert J. Jackson, Jr., Statement on Shareholder Voting 1 (Sept. 14, 2018) (referring to Proxy Voting by Investment Advisers, Investment Adviser Act Release No. 2,106, 68 Fed. Reg. 6,585 (final rule Feb. 7, 2003)), https://www.sec.gov/news/public-statement/statement-jackson-091418.

[5] *See, e.g.*, Letter from Theresa Whitmarsh, Executive Director and Gary Bruebaker, Chief Investment Officer, State of Washington, State Investment Board to Mr. Brent Fields, Secretary, Securities and Exchange Commission 2 (Nov. 14, 2018) ("Our governance duties and the scale of our investment program require that we have access to competitive, independent proxy research services in support of our staff's implementation of voting."), https://www.sec.gov/comments/4-725/4725-4647021-176486.pdf.

[6] *See, e.g.*, U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Capital Markets at 31 (Oct. 2017) ("institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements") https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[7] *See, e.g.*, Stephen J. Choi et al., 59 Emory L.J. 869, 869 (2010) (distinguishes correlation from causality and concluding that the impact of ISS recommendations on shareholder votes is "substantially overstate[d] . . . ."), https://scholarship.law.upenn.edu/faculty_scholarship/331/.

say-on-pay proposals at 12.3% of Russell 3000 companies through Nov. 1, 2018, only 2.4% of those proposals received less than majority support from shareowners.[8] Similarly and for the same period, although ISS recommended voting against or withholding votes from the election of 11.6% of uncontested director-nominees, just 0.2% failed to obtain majority support.[9]

The responsibility for appropriate use of proxy advisory firms rests with investors – the users of the research and services.[10] In 2014, the SEC staff wisely issued guidance, in Staff Legal Bulletin No. 20, reaffirming that investment advisors have an ongoing duty to maintain oversight of proxy research firms and other third-party voting agents.[11] Importantly, that duty includes:

> [A]scertain[ing], among other things, whether the proxy advisory firm has the *capacity and competency* to adequately analyze proxy issues. In this regard, investment advisers could consider, among other things: the adequacy and quality of the proxy advisory firm's staffing and personnel; the *robustness of its policies and procedures* regarding its ability to (i) *ensure that its proxy voting recommendations are based on current and accurate information* and (ii) *identify and address any conflicts of interest* and any other considerations that the investment adviser believes would be appropriate in considering the nature and quality of the services provided by the proxy advisory firm.[12]

CII and many institutional investors publicly supported the 2014 guidance.[13] We are unaware of any compelling evidence indicating that the guidance is not being followed or that more regulation of proxy research firms is necessary or in the best interests of investors, companies, or the capital markets generally.[14]

Our view was generally shared by a broad range of participants at the November 15, 2018 SEC roundtable on the proxy process (Roundtable).[15] Notably, at the end of the Roundtable when the

---

[8] ISS Voting Analytics Database (Nov. 2, 2018) (on file with CII).
[9] *Id.*
[10] *See* Letter from Aeisha Mastagni at 4 ("As an end user of proxy research, we are well positioned to assess the quality of the firms' services.").
[11] SEC Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms 2-3 (June 30, 2014) (describing the investment adviser's ongoing duty to oversee a proxy advisory firm that it retains), https://www.sec.gov/interps/legal/cfslb20.htm.
[12] *Id.* (emphasis added & footnotes omitted).
[13] *See, e.g.*, Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services et al. 5 (July 23, 2014) ("Consistent with our recommendation, the Guidance clarifies that investment advisers are not required to vote every proxy."), https://www.cii.org/files/issues_and_advocacy/correspondence/2014/07_23_14_letter_Subcommittee_Capital_Markets.pdf.
[14] *See* Letter from Thomas P. DiNapoli at 5 ("Any changes to alter the current business operations of proxy advisory firms would make it harder for shareowners to get the information we need and is not the type of 'corporate governance reform' investors have requested, want, or need."), *see also* Commissioner Robert J. Jackson, Jr. at 1 ("Rigorous review of the evidence shows . . no basis for . . . policy changes" regarding proxy research firms); *see generally*, Myth v. Fact, Protect the Voice of Shareholders (last visited Dec. 4, 2018) (ISS & CII website responding to myths raised by some critics of proxy research firms), https://www.protectshareholders.org/myth-vs-fact.
[15] *See, e.g.*, Adé Heyliger & Aabha Sharma, Weil, Gotshal & Manges LLP, Key Takeaways from the SEC's Proxy Process Roundtable: Is Proxy Voting Reform on the Horizon, Governance & Securities Alert 4 (Nov. 20, 2018).

SEC staff asked if proxy advisory firms need additional regulation, no panelist—including those speaking on behalf of the corporate community and the former Chairman of the Committee on Banking Housing and Urban Affairs—voiced any need for new regulations.[16]

2. The shareowner proposal process

CII and its members have a deep interest in ensuring that Rule 14a-8,[17] the federal rule that governs shareowner proposals, is a fair and workable standard for shareowners and companies.[18] The rule provides an orderly means to mediate differences between managers and owners.

Shareowners can actively engage with company boards and management along a spectrum, from letter writing and meetings, to shareowner proposals, to full-scale proxy fights or legal action. Shareowner proposals permit investors to express their vote collectively on issues of concern to them, without the cost and disruption of waging proxy fights.

One-on-one engagement is not a substitute for collective expression of views permitted by shareowner proposals, and proxy fights are simply inappropriate for pursuit of many issues of concern to various shareowners. Moreover, shareowner proposals provide a means for shareowners to communicate not just with management and the board, but also with other shareowners, also to gauge whether other investors share concerns and approaches on a particular issue.

("[i]nterestingly, when asked by an SEC Staff member whether proxy advisors should be subject to enhanced regulation, there was far from overwhelming support for the idea"), https://governance.weil.com/whats-new/key-takeaways-from-the-secs-proxy-process-roundtable-is-proxy-voting-reform-on-the-horizon/.

[16] *Id.*

[17] 17 CFR 240.14a-8, Shareholder Proposals, (Sept. 16, 2010), *available at* https://www.law.cornell.edu/cfr/text/17/240.14a-8.

[18] *See* Examining the U.S. Proxy Voting System: Is it Working for Everyone, Corporate Governance Roundtable, hosted by Rep. Scott Garrett, 114th Cong (Nov. 16, 2015) (Statement of Amy Borrus, Interim Executive Director, Council of Institutional Investors at 7), https://www.cii.org/files/issues_and_advocacy/correspondence/2015/11_16_15_cii_Rep%20_Garrett_roundtable_submission_amy_borrus.pdf; *see generally* Joint Statement on Defending Fundamental Shareowner Rights 1 (June 2, 2017) (commenting that "**ability of shareowners to file shareholder proposals is a fundamental investor right first established by the federal government in 1942 for reasons that remain vital today,**" and signed by Comptrollers, Controllers, and/or Treasurers of the City of New York, and states of California, Connecticut, Illinois, Massachusetts, Oregon, Pennsylvania and Rhode Island), https://www.cii.org/files/issues_and_advocacy/financial_regulation/Joint%20Statement%20on%20Shareowner%20Rights%206_2_2017%20FINAL.pdf.

We are mindful that many improvements in U.S. corporate governance practices would not have occurred without a robust shareowner proposal process in place.[19] For example:

- Shareowner proposals gave impetus to the practice—now largely mandated by major U.S. stock exchanges' listing standards—that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance. Similarly, investors pressed for independent board leadership, now prevalent at U.S. companies through independent lead directors or independent chairs, primarily through shareowner proposals in the 1990s.[20]

- In 1987, an average of 16% of shares were voted in favor of shareowner proposals to declassify boards so that directors stand for election annually. In 2012, these proposals enjoyed an 81% average level of support. Ten years ago, less than 40% of S&P 500 companies held annual director elections compared to more than two-thirds of these companies today.[21]

- Electing directors in uncontested elections by a majority—rather than plurality—vote was considered a radical idea 15 years ago when advocated by shareowners through proposals filed with numerous companies. Today, 90% of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareowner support for majority voting proposals.[22]

- Proxy access proposals built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years. Resolutions filed by the New York City Comptroller and other pension funds to allow shareowners meeting certain eligibility requirements to nominate directors on the company's proxy ballot

---

[19] Letter from Thomas P. DiNapoli at 2 ("The Fund believes that shareholder proposals are an essential engagement tool to promote corporate transparency and accountability, and to provide an opportunity to bring specific issues to the attention of boards, management and fellow investors."); Statement of New York City Comptroller Scott M. Stringer on the April 19th Discussion Draft of the Financial CHOICE Act of 2017 (Act) 3 (Apr. 25, 2017) (describing some of the many achievements "made possible because of the NYC Pension Funds' long-standing right and ability to file shareholder proposals—a right and ability that would be pointlessly eviscerated by the passage of the Act"), https://comptroller.nyc.gov/newsroom/testimonies/statement-of-new-york-city-comptroller-scott-m-stringer-on-the-april-19th-discussion-draft-of-the-financial-choice-act-of-2017-act/.

[20] Joint Statement on Defending Fundamental Shareowner Rights at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Independent Directors*" shareowner proposals); Ceres et al., The Business Case for the Current SEC Shareholder Proposal Process 6 (Apr. 2017), https://www.ussif.org/files/Public_Policy/Comment_Letters/Business%20Case%20for%2014a-8.pdf; IRRC Corporate Governance Bulletin, "Independence of Directors Emerges as Major 1993 Issue," IRRC (Nov./Dec. 1992) (on file with CII).

[21] Joint Statement on Defending Fundamental Shareowner Rights at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Annual Election of Directors*" shareowner proposals); Ceres et al. at 6.

[22] Joint Statement on Defending Fundamental Shareowner Rights at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Majority Voting for Election of Directors*" shareowner proposals); Ceres et al. at 6.

achieved majority votes at numerous companies. As a result, since 2015, more than 400 public companies have adopted proxy access bylaws.[23]

Cost and Benefits to Companies

The cost to public companies of the existing shareowner proposal process is generally low and the process often results in benefits to companies.[24] It is important to note that most companies receive few, if any, shareowner proposals.[25]

The average Russell 3000 company can expect to receive a proposal every 7.7 years.[26] In addition, proposals are typically filed with larger companies (i.e., S&P 500) that have the resources to address such shareowner input.[27]

For companies that do receive a proposal, the median number of proposals is one per year.[28] When shareowners file proposals, companies often agree to act on the request made in the proposal. In this respect, an average of 37.5% of shareowner proposals broadly related to climate change during the 2012-2016 proxy seasons were withdrawn by filers in response to the company agreeing to the request in some manner.[29]

The withdrawal rates for several other topics are much higher.[30] This outcome suggests that many companies find benefits from committing to act on shareowner proposals prior to a vote.

Ownership and Resubmission Requirements

SEC Rule 14a-8 establishes a *de minimis* eligibility criteria to apply to shareowners who own at least $2,000 or 1% of a company's securities eligible to vote for a holding period of one year.[31] Some critics of the rule argue that the eligibility criteria should be updated and "in particular that there should be a 'meaningful' ownership standard (both amount and length of stock ownership)."[32]

---

[23] Joint Statement on Defending Fundamental Shareowner Rights at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Shareowner Access to the Proxy*" shareholder proposals); Ceres et al. at 6.
[24] *See* Ceres et al. at 11-12 (providing an analysis of the potential range of company costs).
[25] According to the ISS Voting Analytics database of Russell 3000 companies on file with CII, shareowners submitted an average of 836 proposals at 386 companies per year between 2004 and 2017. The number of submitted proposals fluctuated between approximately 800-1000 proposals per year, except for a dip to 603 proposals in 2011 and 673 proposals in 2012 after the SEC's adoption of say-on-pay vote requirements. According to Gibson Dunn, "shareowners submitted 788 proposals during the 2018 proxy season, down 5% from 827 in 2017 and down 14% from 916 in 2016." Gibson Dunn, Shareholder Proposal Developments During the 2018 Proxy Season 3 (July 12, 2018), https://www.gibsondunn.com/shareholder-proposal-developments-during-the-2018-proxy-season/.
[26] ISS Voting Analytics database (on file with CII).
[27] *See* Ceres et al. at 12 (discussion of frequency of shareowner proposals at public companies).
[28] *Id.*
[29] Data compiled by Ceres (on file with CII).
[30] *See* Ceres et al. at 11 ("The New York City Comptroller's Office withdrew 80 percent of the 45 proxy access resolutions it filed during the 2016 and 2017 proxy seasons due to commitments by 36 companies.").
[31] 17 CFR 240.14a-8(b).
[32] *See, e.g.*, Adé Heyliger & Aabha Sharma at 2.

We generally believe the current Rule 14a-8 requirements with respect to the size of the shareowner's holdings and the time period that a shareowner must hold shares in the company before making a proposal are appropriate. As we stated in our March 5, 2018, joint letter with Ceres, the Interfaith Center on Corporate Responsibility and US SIF:

> Under Rule 14a-8, the one-year holding requirement ensures that the use of shareholder proposals is appropriately limited to longer-term shareholders. It also harnesses the power of a marketplace of ideas. Barring small investors from participating in this marketplace would be as unwise as it is unfair. Prior to the SEC's adoption in 1983 of a $1,000 requirement, there was no dollar threshold for submitting a proposal. The SEC increased the threshold in 1998 to $2,000. However, the SEC declined to increase the threshold further "out of concern that a more significant increase would restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders." If the amount were adjusted for inflation since 1998, the current threshold would increase to about $2,946. As such, the existing filing threshold is close to what the SEC maintained in 1998 was necessary to avoid excluding smaller shareholders.[33]

Rule 14a-8 also governs the resubmission of such proposals.[34] Pursuant to that provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the company may exclude the proposal for any shareowner meeting held within three (3) calendar years of the last submission if the proposal received; less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third and subsequent submissions.[35]

Some critics of Rule 14a-8 suggest that the current resubmission levels should be raised to reduce the number of proposals filed repeatedly for a number of years.[36] The data often referenced to support those claims is, at best, selective and without context.[37]

---

[33] Letter from Ken Bertsch, Executive Director, Council of Institutional Investors et al. to the Honorable Mike Crapo, Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate et al. 4 (Mar. 5, 2018) (footnotes omitted), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/Ltr%20to%20Congress%20Regarding%20S%202155.pdf.

[34] 17 CFR 240.14a-8(i)(12); *see* SEC SLB No. 14J, Shareholder Proposals (Oct. 23, 2018) (providing more guidance, including the further expansion of certain other exclusions provided under Rule 14a-8), https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals.

[35] *Id.*

[36] *See, e.g.,* Letter from Chris Natram, Vice President, Tax and Domestic Economic Policy to Brent J. Fields, Securities and Exchange Commission 7 (Oct. 30, 2018) ("NAM urges the SEC to . . . implement increased resubmission thresholds . . ."), https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf.

[37] *Id.* (referencing data indicating that "nearly 30 percent of all proposals had been submitted three or more times" but failing to reference data regarding the percentage support for those proposals or the percentage of those proposals that obtain majority support or result in companies engaging with proponents to reach a mutually agreeable solution).

To a provide a basis for a more informed discussion on this topic, our affiliate, the Council of Institutional Investors Research and Education Fund has issued an analysis of the more than 3,600 shareowner proposals that went to votes at Russell 3000 companies between 2011 and 2018 (CII-REF Analysis).[38] While we concede that the existing resubmission thresholds, put in place in 1954, reflected an era when there was much lower support for shareowner proposals, the CII-REF Analysis indicates that the allegation that large numbers of shareowner proposals are pursued year after year with low voting support is overstated.[39] More specifically, the CII-REF Analysis shows that only about one-third of all shareowner proposals are ever resubmitted.[40] Moreover, the average and median level of support for resubmitted proposals is consistently higher than 28% of the shares voted.[41]

In addition, we note that the existing resubmission thresholds do not account for dual class stock companies with unequal voting rights. As one example, a shareowner proposal at Facebook this past year requested that "Facebook's Board issue a report discussing the merits of establishing a Risk Oversight Board Committee (at reasonable cost, within a reasonable time, and omit confidential and proprietary information)."[42] While the proposal was supported by only 11.55% of all shares, the vote represented 45% of all non-insider shares.[43]

We generally share the reported view of "certain [SEC] staff members [that] left the [November 15th SEC] roundtable with the impression that stronger arguments were made in favor of keeping the current Rule 14a-8 eligibility requirements and resubmission thresholds."[44] As summarized by Roundtable participant and CII board member Aeisha Mastagni of the California State Teachers' Retirement System:

> [W]e believe the current regulations surrounding 14a-8 are working and function in a fair equitable manner. Also since shareholder proposals constitute only 2% to 3% of the proposals, we underscore, "why try to remedy a problem that really doesn't exist?"[45]

3. Retail shareowner participation

CII recognizes that there exists no panacea for the problem of low retail investor participation.

---

[38] Brandon Whitehill, Clearing the Bar: Shareholder Proposals and Resubmission Thresholds, CII Research and Education Fund (Nov. 2018), https://www.ciiref.org/resubmission-thresholds.
[39] *See id.* at 6-7.
[40] *Id.* at 6 ("Two-thirds of the proposals winning at least 3% support in the first attempt were never resubmitted despite being eligible.").
[41] *Id.* at 7 ("Support varied modestly in subsequent attempts but exceeded the resubmission thresholds across all attempts.").
[42] Trillium Asset Management, FaceBook—Risk Oversight Committee (last visited Dec. 4, 2018), http://www.trilliuminvest.com/shareholder-proposal/facebook-risk-oversight-committee-2018/; *see generally* Press Release, Council of Institutional Investors, Investors Petition NYSE, NASDAQ to Curb Listings of IPO Dual-Class Share Companies (Oct. 24, 2018) (describing CII concerns about companies with dual-class share structures), https://www.cii.org/files/issues_and_advocacy/correspondence/FINAL%20Dual%20Class%20Petition%20Press%20Release%20Oct%2024,%202018.pdf.
[43] *Id.*
[44] Adé Heyliger & Aabha Sharma at 3.
[45] Letter from Aeisha Mastagni at 3.

Increasing retail voting is likely to involve multiple initiatives, which may include investor education campaigns, enhancements to brokers' online platforms, and other uses of technology.

We do not have a membership approved policy with respect to client-directed voting. However, we would be concerned about a rigid form of client-directed voting, in which shareowners must choose among always voting with management, always voting against management, or always voting in accordance with a third party. We continue to believe that a robust system of client-directed voting should be nimble enough to accommodate the nuances of a shareowner's true preferences, allow for the revocation of advance instructions, and involve periodic reaffirmation of those instructions.[46]

****

CII would be very happy to discuss its perspective in more detail. I can be can be reached at jeff@cii.org or by telephone at (202) 822-0800.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel

CC: The Honorable Dean Heller, Chairman, Subcommittee on Securities, Insurance, and Investment, Committee on Banking, Housing, and Urban Affairs
The Honorable Mark Warner, Ranking Member, Subcommittee on Securities, Insurance and Investment, Committee on Banking, Housing, and Urban Affairs
The Honorable Richard Shelby, Committee on Banking, Housing, and Urban Affairs
The Honorable Bob Corker, Committee on Banking, Housing, and Urban Affairs
The Honorable Patrick J. Toomey, Committee on Banking, Housing, and Urban Affairs
The Honorable Tim Scott, Committee on Banking, Housing, and Urban Affairs
The Honorable Ben Sasse, Committee on Banking, Housing, and Urban Affairs
The Honorable Tom Cotton, Committee on Banking, Housing, and Urban Affairs
The Honorable Michael Rounds, Committee on Banking, Housing, and Urban Affairs
The Honorable David Perdue, Committee on Banking, Housing, and Urban Affairs
The Honorable Thom Tillis, Committee on Banking, Housing, and Urban Affairs
The Honorable John Kennedy, Committee on Banking, Housing, and Urban Affairs
The Honorable Jerry Moran, Committee on Banking, Housing, and Urban Affairs
The Honorable Jack Reed, Committee on Banking, Housing, and Urban Affairs
The Honorable Robert Menendez, Committee on Banking, Housing, and Urban Affairs
The Honorable John Tester, Committee on Banking, Housing, and Urban Affairs

[46] *See, e.g.*, Letter from Glenn Davis, Senior Research Associate, Council of Institutional Investors to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission 4 (Oct. 14. 2010) (on file with CII).

The Honorable Elizabeth Warren, Committee on Banking, Housing, and Urban Affairs
The Honorable Heidi Heitkamp, Committee on Banking, Housing, and Urban Affairs
The Honorable Joe Donnelly, Committee on Banking, Housing, and Urban Affairs
The Honorable Brian Schatz, Committee on Banking, Housing, and Urban Affairs
The Honorable Chris Van Hollen, Committee on Banking, Housing, and Urban Affairs
The Honorable Catherine Cortez Masto, Committee on Banking, Housing, and Urban Affairs
The Honorable Doug Jones, Committee on Banking, Housing, and Urban Affairs

Corporate Reform Coalition

December 3, 2018

The Honorable Mike Crapo, Chairman
The Honorable Sherrod Brown, Ranking Member
United States Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown,

The Corporate Reform Coalition appreciates the opportunity to weigh in on the hearing entitled "Proxy Process and Rules: Examining Current Practices and Potential Changes" held by the Senate Committee on Banking, Housing, and Urban Affairs on Thursday, December 6, 2018. The Coalition is comprised of investors, academics, and national and state- based nonprofit organizations that are all seeking disclosure of corporate engagement in politics. The proxy process is important to the coalition's members who, in their role as shareholders and members of the public, have been holding companies accountable for risky, undisclosed political activity for almost a decade. As the Committee debates changes to the proxy process, this coalition encourages the members of the Committee to remain focused on increasing shareholder democracy and expanding shareholders' access to material information including environmental, social, and governance (ESG) risks.

The current rules and practices governing the way shareholders file proposals and vote in corporate elections are democratic ones, as they allow shareholders to dialogue with their companies about important issues, and hold corporate managers accountable. The Committee should use this hearing to focus on strengthening the proxy process with the goal that every retail shareholder vote is counted in corporate elections, that they have full access to the proposal process, and that they have access to the information they need to make smart investment decisions.

The Focus on Proxy Advisors is a Distraction from True Reform

The recent roundtable held by the Securities and Exchange Commission (SEC) on this topic focused significantly on proxy advisory firms. This focus on proxy advisors is a distraction being pushed by special interests that do not want to see shareholder rights expanded. It's hard to see how firms that provide shareholders with more information about their companies could be harmful.

The U.S. Chamber of Commerce, which has been invited to testify at the hearing, and the National Association of Manufacturers are two of the main industry groups pushing the focus on proxy advisors. Both of these organizations represent some of the country's largest corporations who have been facing consistent calls from their shareholders to disclose how they are planning for the impact of long- term issues. It is clear that these groups would prefer to steer the conversation away from expanding shareholder access that would challenge the status quo that benefits their members at the expense of retail investors. It is important that the members of the Committee keep the focus on what is best for retail investors, which is building upon the existing system and expanding shareholder tools to engage with managers. Engagement between shareholder proponents and their companies often leads to productive conversations and the adoption of strong oversight policies. On corporate political spending, for example, engagement has led to almost 300 companies disclosing their political spending, including more than half of the S&P 100.

Investors Want More Disclosure, Not Less

The call from investors for increased disclosure is only growing. In the 2018 proxy season roughly 80 public companies faced shareholder resolutions calling for their companies to be completely honest about how they attempt to influence politics. This year's resolutions are a continuation of a trend that started with the 2011 petition for a rulemaking at the SEC on corporate political spending disclosure. Since being filed, the petition has received over 1.2 million public comments— the most in the agency's history.

In addition to the comments that have poured in to the political spending disclosure petition, the SEC received over 26,500 comments in response to its 2016 Concept Release on Business and Financial Disclosure Required by Regulation S-K, the overwhelming majority of which expressed a demand for more and better disclosure in general. Moreover, in October of 2018, investors representing more than $5 trillion in assets under management filed a new petition for a rulemaking on ESG disclosure. This petition has received more than 3,300 comments to date.

Increasing Retail Investor Access to the Proxy Process is Critical

As Congress and the SEC consider ways to increase retail participation in the shareholder process, this Coalition expresses its support for ensuring that Americans who are invested through mutual funds have the ability to influence how their shares are voted. The large mutual fund companies like Vanguard, BlackRock, and Fidelity hold significant voting shares at most major public companies and it is important to ensure that the mutual fund companies are accurately representing their retail clients' complete interests when voting their proxies.

While shareholders are increasingly asking for more information from their corporate managers, the distraction from those conversations is an obvious attempt to move the conversation away from meaningful disclosure. The SEC's recent Proxy Roundtable and this upcoming hearing are important opportunities to continue a critical conversation about expanding existing shareholder rights to give all retail investors even easier ways to dialogue with their companies about important issues impacting the success of their business. At the SEC's Proxy Roundtable, Chairman Clayton asked how the proxy process can facilitate long-term investors' confidence that they are making informed, company- specific voting decisions. Corporate managers have different approaches to political engagement therefore corporate political spending disclosure is company- specific information that investors are entitled to. Long-term investors deserve to know whether their companies' leaders are managing these risks appropriately. Again, the Coalition appreciates the opportunity to weigh in on this important topic. Should members of the Committee or their staff have any questions, please reach out to Rachel Curley at member organization Public Citizen via email at rcurley@citizen.org or via phone at 202-454-5195.

Sincerely,

The Corporate Reform Coalition

Investment Advisers Act of 1940 - Rule 206(4)-6
Egan-Jones Proxy Services

May 27, 2004

Kent S. Hughes
Managing Director
Egan-Jones Proxy Services
61 Station Road
Haverford, PA 19041

Dear Mr. Hughes:

In your letter dated December 16, 2003, you ask for guidance concerning investment advisers that use the recommendations of independent third parties to vote client proxies. Your inquiry generally relates to the circumstances under which a third party may be considered independent under Rule 206(4)-6 under the Investment Advisers Act of 1940 (the "Advisers Act"), which was adopted by the Commission to address the voting of proxies by investment advisers on behalf of their advisory clients.[1] This letter confirms and expands upon the guidance that we provided to Egan-Jones Proxy Services ("Egan-Jones") on January 15, 2004.[2]

An investment adviser may face direct and indirect conflicts of interest in voting the proxies of its clients, including its fund clients, when it has the discretionary authority to vote the proxies.[3] For instance, if a broker-dealer that is affiliated with an investment adviser provides investment banking services to an issuer that is soliciting proxies, that relationship could influence the adviser to vote its clients' proxies in its affiliate's interest, rather than in the best interests of its clients, thus breaching the adviser's fiduciary duty of loyalty to its clients.[4] To address these and other conflicts, the Commission adopted Rule 206(4)-6 under the Advisers Act to require registered investment advisers to adopt and implement policies and procedures that are designed to ensure that their clients' proxies are properly voted, material conflicts are avoided and fiduciary obligations are otherwise fulfilled.

In the Rule 206(4)-6 Adopting Release, the Commission indicated that an investment adviser could demonstrate that its vote of its clients' proxies was not a product of a conflict of interest if the adviser voted the proxies in accordance with a pre-determined policy based on the recommendations of an independent third party.[5] An investment adviser that votes client proxies in accordance with a pre-determined policy based on the recommendations of an independent third party will not necessarily breach its fiduciary duty of loyalty to its clients even though the recommendations may be consistent with the adviser's own interests. In essence, the recommendations of a third party that is in fact independent of an investment adviser may cleanse the vote of the adviser's conflict.[6]

An investment adviser that retains a third party to make recommendations regarding how to vote its clients' proxies should take reasonable steps to verify that the third party is in fact independent of the adviser based on all of the relevant facts and circumstances. A third party generally would be independent of an investment adviser if that person is free from influence or any incentive to recommend that the proxies should be voted in anyone's interest other than the adviser's clients. Such a person generally could not be an "affiliated person" of the investment adviser as that term is defined in the Advisers Act, or have any material business, professional, or other relationship with the investment adviser.[7] For example, a person that provides services to an investment adviser's employee benefit plan in exchange for compensation may be inclined to recommend that the proxies should be voted in the interests of the adviser in order to curry favor and maintain its business relationship with the adviser.[8]

In your letter, you ask whether a proxy voting firm would be considered to be an independent third party if the firm receives compensation from an issuer ("Issuer") for providing advice on corporate governance issues. We believe that the mere fact that the proxy voting firm provides advice on corporate governance issues and receives compensation from the Issuer for these services generally would not affect the firm's independence from an investment adviser.[9]

An investment adviser should not, however, conclude that it is appropriate to follow the voting recommendations of an independent proxy voting firm without first ascertaining, among other things, whether the proxy voting firm (a) has the capacity and competency to adequately analyze proxy issues, and (b) can make such recommendations in an impartial manner and in the best interests of the adviser's clients. An investment adviser could breach its fiduciary duty of care to its clients by voting its clients' proxies based upon the proxy voting firm's recommendations with respect to an Issuer because the proxy voting firm could recommend that the adviser vote the proxies in the firm's own interests, to further its relationship with the Issuer and its business of providing corporate governance advice, rather than in the interests of the adviser's clients. The proxy voting firm's relationship with an Issuer thus may present a conflict of interest that is in addition to any conflict of interest that the investment adviser may have.

Accordingly, an investment adviser should obtain information from any prospective independent third party to enable the adviser to determine that the third party is in fact independent, and can make recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients. An investment adviser should establish and implement procedures to identify and address conflicts that can arise on an ongoing basis concerning the third party.[10] For instance, under the circumstances that you describe in your letter, the procedures should require a proxy voting firm that is called upon to make a recommendation to an investment adviser regarding the voting of an Issuer's proxies to disclose to the adviser any relevant facts concerning the firm's relationship with an Issuer, such as the amount of the compensation that the firm has received or will receive from an Issuer. That information will enable the investment adviser to determine whether the third party can make recommendations about how to vote the clients' proxies in an impartial manner and in the best interests of the clients, or whether the adviser needs to take other steps to vote the proxies.[11]

Rule 206(4)-6 under the Advisers Act requires an investment adviser to adopt and implement written policies and procedures that are designed to ensure that its clients' proxies are voted in the clients' best interests, to describe these policies and procedures to their clients, and to provide a copy of these procedures to clients upon request.[12] Those procedures should address the use of any independent third party to make recommendations regarding the voting of the proxies of an investment adviser's clients if the use of an independent third party is a material part of the adviser's proxy voting policies. We note that, similarly, a fund must disclose to its shareholders the policies and procedures that it follows for voting proxies, in particular, the procedures that the fund follows when a vote presents a conflict between the interests of the fund shareholders, on the one hand, and those of the fund's investment adviser, principal underwriter, or any affiliated person of the fund, its investment adviser, or its principal underwriter, on the other.[13] In addition, if applicable, a fund must disclose in its registration statement that an independent third party makes voting recommendations, or otherwise votes the fund's proxies, and must also disclose the policies and procedures used by the third party to vote the fund's proxies.[14]

We hope that this information is helpful. Please note that we take no position regarding whether an investment adviser should hire Egan-Jones as an independent third party to vote the proxies of the investment adviser's clients. The decision to hire Egan-Jones in that capacity rests entirely with the investment adviser. If you have additional questions, you may telephone Kathleen L. Knisely, Senior Counsel, or Alison M. Fuller, Assistant Chief Counsel, at 202-942-0659.

Very truly yours,

Douglas Scheidt
Associate Director and
Chief Counsel

Endnotes

[1] See Investment Advisers Act Release No. 2106 (Jan. 31, 2003) (adopting Rule 206(4)-6)("Rule 206(4)-6 Adopting Release"). The Commission also adopted Rule 30b1-4 under the Investment Company Act of 1940 (the "Company Act"), which requires registered investment companies ("funds") annually to file with the Commission their proxy voting records on new Form N-PX. See Investment Company Act Release No. 25922 (Jan. 31, 2003). In addition, the Commission amended Forms N-1A and N-2 under the Company Act to add Items 13 and 16, respectively, which require funds to disclose their proxy voting policies and procedures. Id.

[2] Telephone conversation on January 15, 2004 among Kathleen L. Knisely and Alison M. Fuller of the staff and Sean Egan and Gale Gillespie of Egan-Jones.

[3] The board of directors (the "Board") of a fund typically delegates the responsibility for voting fund proxies to the fund's investment adviser.

[4] As the Commission explained in the Rule 206(4)-6 Adopting Release, an investment adviser (or its affiliate) may manage a pension plan, administer employee benefit plans, or provide brokerage, underwriting, insurance or banking services to a company whose management is soliciting proxies. The investment adviser's failure to vote in favor of management may harm the adviser's relationship with the company. The adviser also may have business or personal relationships with other proponents of proxy proposals, participants in proxy contests, corporate directors or candidates for directorships. For example, the adviser may manage money for an employee group, or an executive of the adviser may have a spouse or other close relative who serves as a director or executive of a company. See Rule 206(4)-6 Adopting Release. See also In the Matter of Deutsche Asset Management, Investment Advisers Act Release No. 2160 (August 19, 2003).

[5] The Commission also indicated that an adviser could adopt and implement a policy of disclosing to its clients the conflict of interest and obtain its clients' consents before voting the shares. See Rule 206(4)-6 Adopting Release.

[6] We note that an investment adviser would not cleanse itself of its conflict of interest by hiring an independent third party to make proxy voting recommendations when the adviser already knows that the third party's recommendations are consistent with the adviser's own interest.

[7] See Section 202(a)(12) of the Advisers Act (defining "affiliated person"). Cf. Section 2(a)(4)(vii) of the Company Act (defining "interested person). See also Investment Company Act Release No. 24083 (Oct. 14, 1999) (discussing when a material business or professional relationship may impair the independence of a prospective independent director of a fund).

[8] We also note that a third party might not be in fact independent of an investment adviser due to a material business or professional relationship with an affiliated person of the adviser. For instance, a third party might not be independent if it had a material business relationship with an investment adviser's broker-dealer affiliate that provides investment banking services to the issuer that is soliciting the proxies.

[9] Similarly, the provision of services by a third party to an investment adviser's client would not necessarily affect the independence of that third party. See generally Evergreen Investment Management Company (pub. avail. Feb. 13, 2002) (the staff agreed not to recommend enforcement action under Section 17(a) of the Company Act concerning a transaction between certain funds and persons that were affiliated with the funds. In connection with the transaction, the funds hired their unaffiliated custodian to act as a fiduciary in voting the funds' proxies because the vote presented a conflict of interest for the funds' investment adviser).

[10] We note that, as part of its proxy voting procedures, an investment adviser could obtain a representation from an independent third party, each time that the third party makes a voting recommendation, that the third party faces no conflict of interest with respect to the vote.

[11] The investment adviser could, for instance, allow the independent third party to vote only the proxies of issuers with respect to which the third party had no conflict of interest, or the adviser could itself vote those

proxies, provided that the adviser had no conflict of interest of its own with respect to the issuers.

[12] See Rule 206(4)-6 Adopting Release.

[13] See Item 13, Form N-1A. You ask whether a fund that uses an independent third party to make proxy voting recommendations must disclose that the third party has an agreement with the Issuer to provide corporate governance advice in exchange for compensation ("compensation agreement"). Form N-1A does not specifically require a fund to disclose to its shareholders the existence of such a conflict of interest. As with any information that Form N-1A does not specifically address, a fund must evaluate whether disclosure regarding a compensation agreement is necessary to make any statements, including any statements regarding the fund's proxy voting policies, not misleading. See, e.g., Section 34(b) and Rule 8b-20 under the Company Act.

[14] See Investment Company Act Release No. 25922 (Jan. 31, 2003).

Incoming Letter

December 16, 2003

Mr. Douglas Scheidt
Associate Director and Chief Counsel
Division of Investment Management
United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re.: Proxy Voting by Investment Advisors

Dear Mr. Scheidt:

In Section II. A. 2. b. of the Security & Exchange Commission's Final Rule on Proxy Voting by Investment Advisors [17 CFR Part 275; release No. IA-2106; File No. S7-38-02] ("the Rule"), the following language appears in the second paragraph under "Resolving Conflicts of Interest":

> "Advisers today use various means of ensuring that proxy votes are voted in their clients' best interest and not affected by the advisers' conflicts of interest.23 An adviser that votes securities based on a pre-determined voting policy could demonstrate that its vote was not a product of a conflict of interest if the application of the policy to the matter presented to shareholders involved little discretion on the part of the adviser.24 Similarly, an adviser could demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, *based upon the recommendations of an independent third party* [my italics]."

We respectfully request guidance with respect to the definition, in the preceding paragraph, of the term "independent." For example, does the fact that a firm providing proxy research and recommendations (a "Proxy Research Firm") also receives compensation on corporate governance issues from a corporation that is being researched, affect its independence? Also, in such a case, is the Proxy Research Firm required to disclose the existence of its compensation arrangement and the amount of its compensation? Also, is a fund that uses a proxy adviser that accepts compensation from companies regarding which it provides proxy research and recommendations, required to disclose that fact in its registration statement or otherwise in connection with its disclosure of its votes?

In the interest of saving you research time, below are comments from two published articles on the issue of a firm providing proxy research and recommendations and also providing consulting on corporate governance/proxy matters:

> """These two things can`t coexist,"" says Ted White, director of corporate governance for [Proxy Research Firm] client CalPERS, California`s $133 billion state-employee pension fund. ""It`s a whole lot like the audit industry was. You can`t build your business model around a conflict."""

> "[Nell] Minow is now editor of the Corporate Library, which will soon release its own board ratings; her firm does not do business with the

companies it evaluates. ""It would compromise our credibility to take any money from them,"" she says."

We would greatly appreciate your comments on this area and look forward to hearing from you.

Very truly yours,

Kent S. Hughes
Managing Director

http://www.sec.gov/divisions/investment/noaction/egan052704.htm

---

GLASS LEWIS

November 14, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: SEC Staff Roundtable on the Proxy Process – File Number 4-725

Dear Chairman Clayton:

Glass Lewis appreciates the opportunity to submit this statement for the record as part of the SEC Roundtable on the Proxy Process, scheduled to be held on November 15, 2018 ("Roundtable").

Founded in 2003, Glass Lewis is a leading, independent governance services firm that provides proxy research and vote management services to more than 1,300 institutional investor clients throughout the world. While, for the most part, investor clients use Glass Lewis research to help them make proxy voting decisions, these institutions also use Glass Lewis research when engaging with companies before and after shareholder meetings. Further, through Glass Lewis' Web-based vote management system, Viewpoint®, Glass Lewis provides investor clients with the means to receive, reconcile and vote ballots according to custom voting guidelines and record-keep, audit, report and disclose their proxy votes. From its offices in North America (San Francisco, New York and Kansas City), Europe (Limerick, London, and Karlsruhe) and Australia (Sydney), Glass Lewis' 360+ employees provide research and voting services to institutional investors globally that collectively manage more than US $35 trillion.

Glass Lewis believes that governance services firms play an important support role, helping institutional investors meet their fiduciary responsibility to vote thousands of securities in an informed manner, usually in a very compressed timeframe. Providing corporate governance services to institutional investors is Glass Lewis' core business and sole focus. Indeed, Glass Lewis does not offer consulting services to corporate issuers, directors, dissident shareholders or shareholder proposal proponents.

As part of our response, we would like to focus on the role of proxy advisory firms; directly address some of the areas you mentioned may warrant attention as they relate to the proxy voting services we provide to our clients; and provide feedback on some of the other agenda items scheduled to be discussed at the Roundtable.

GLASS LEWIS

The Role of Proxy Advisory Firms

The primary role of a proxy services provider is to execute votes on behalf of investor clients in accordance with the specific instructions of those clients.
To that end, Glass Lewis implements client voting policies on the proxy advisor's vote management system so that each ballot populates with recommendations based on the specific policies of the client, enabling clients to submit votes in a timely and efficient manner. Using the term "robo-voting" to describe how votes are cast by institutional investors that engage the services of a proxy advisor is an unfair characterization of the management and oversight of the voting process by those investors.

The guidance from the SEC in Staff Legal Bulletin No. 20 ("SLB 20") was clear. Institutional investors understand that they are in control of and ultimately responsible for their voting decisions. Though the guidance in SLB 20 was not overly prescriptive, investors do employ a variety of methods to oversee the voting process, beginning with their selection of a proxy advisor and continuing throughout their use of that proxy advisor.

Each investor client owns the formulation of its voting policies. For instance, during the policy formulation process, an institution will thoroughly review the policies of its proxy advisor to assess the similarities and differences between the institution's views on certain issues versus the views of the proxy advisor, as noted in its house policy. In some instances, an investor client may elect to implement the same policy as the proxy advisor for some or all of the issues up for vote. Mainly because, after completing an extensive due diligence process, the institution determines that the proxy advisor's policy is philosophically aligned with its own policy, as well as with the views of its investment management team, proxy committee, mutual fund board or other decision-making bodies within its organization. This practice of adopting all or some of an advisor's house policy, however, is by no means the norm.

The vast majority of institutional investors who engage a proxy advisor are opting for increasingly more detailed policies with specific views on how to address all issues that may come up on a proxy (e.g. U.S. companies alone have approximately 250 issues). More importantly, in many instances, their views are so specific to each unique situation that they will often opt for case-by-case analysis. Arguing that proxy advisors exert undue influence on investors is simply untrue. This is clearly evidenced by the fact that during the 2017 proxy season Glass Lewis recommended voting FOR 92% of the proposals it analyzed from the U.S. issuer meetings it covers (the board and management of these companies recommended voting FOR 98% of the same) and yet, directors received majority FOR votes 99.9% of the time.

GLASS LEWIS

Further, an analysis of Glass Lewis client voting at US meetings from July 1, 2017 through June 30, 2018 showed the following:

- **Say on Pay**
  - Clients whose selected policy is equal to the Glass Lewis policy, yet voted different than Glass Lewis policy: 14% of votes cast.
  - Clients whose selected policy is a policy different than the Glass Lewis policy, yet voted different than the client policy: 37% of votes cast.

- **Shareholder Proposal: Separation of Chairman and CEO**
  - Clients whose selected policy is equal to the Glass Lewis policy, yet voted different than Glass Lewis policy: 14% of votes cast.
  - Clients whose selected policy is a policy different than the Glass Lewis policy, yet voted different than the client policy: 41% of votes cast.

- **Shareholder Proposal: Political Contributions**
  - Clients whose selected policy is equal to the Glass Lewis policy, yet voted different than Glass Lewis policy: 26% of votes cast.
  - Clients whose selected policy is a policy different than the Glass Lewis policy, yet voted different than the client policy: 57% of votes cast.

- **Shareholder Proposal: Gender Pay Equity**
  - Clients whose selected policy is equal to the Glass Lewis policy, yet voted different than Glass Lewis policy: 18% of votes cast.
  - Clients whose selected policy is a policy different than the Glass Lewis policy, yet voted different than the client policy: 61% of votes cast.

- **Shareholder Proposal: Majority Voting**
  - Clients whose selected policy is equal to the Glass Lewis policy, yet voted different than Glass Lewis policy: 13% of votes cast.
  - Clients whose selected policy is a policy different than the Glass Lewis policy, yet voted different than the client policy: 19% of votes cast.

The market is clearly working, as shareholders are voting independently of both proxy advisors and company management.

GLASS LEWIS

As it relates to the actual casting of votes, under no circumstance is Glass Lewis authorized to deviate from a client's instructions or to determine a vote that is not consistent with the policy specified by the client. The pre-population of voting instructions on a ballot strictly adheres to each client's specific voting instructions. Importantly, when a preliminary ballot is ready for review, the proxy advisor's voting system will alert each client and provide clients with all the disclosures and other information they need at their fingertips to review and evaluate the matters up for a vote. Clients can choose to restrict the submission of a ballot until after specified client personnel have reviewed and approved the votes. Clients can also make (and often do make) changes to the preliminary ballot before signing off. And, assuming the voting deadline has not passed, they can even change their vote and resubmit it. Investors take their fiduciary responsibility to vote shares, engage with issuers and operate as good stewards very seriously. This is evidenced by the fact that they regularly audit the voting to ensure their proxy advisor is processing their ballots in accordance with their pre-established instructions.

Also, worth noting, is the clear fact that the rationales for arriving at a vote decision, especially amongst investors, are often varied, even if the vote is ultimately the same. In many instances, when companies are talking to shareholders, engaging with proxy advisors and reading such advisors' publicly-available policies and methodologies, it should come as no surprise that the voting results may mirror the recommendations issued by proxy advisors as there are many commonly accepted governance principles used by both investors and advisors. To state that investor clients are "robo-voting" their proxies simply because of the existence of default electronic voting, combined with the speed with which votes are cast, and the fact that clients' votes often mirror the recommendations issued by proxy advisors, implies a true lack of understanding of an investor's fiduciary obligations and how they honor it (not to mention, the role of its proxy advisor).

Roundtable Topics Related to Proxy Advisors

1. Have various factors, including legal requirements, resulted in investment advisers, funds and other clients relying on proxy advisory firms for information aggregation and voting recommendations to a greater extent than they should? Is the extent of reliance on these firms in the best interests of investment advisers and their clients, including funds and fund shareholders?

Institutional investors have a fiduciary responsibility to vote proxies in a manner that is in the best interests of their beneficiaries. Availing themselves of qualified advisors – such as Glass Lewis – whose interests are aligned with those of their institutional investor clients to help fulfill this responsibility is prudent and by no means undermines a beneficiary's rights.

As mentioned above, the supermajority of Glass Lewis clients, which include the majority of the world's largest public pension funds, asset managers and mutual funds, vote according to a custom policy or via a custom process, in what is becoming the standard practice among

GLASS LEWIS

institutional investors. Accordingly, custom policy clients rely on Glass Lewis more for data and custom analysis than for Glass Lewis' voting recommendations.

Glass Lewis supports its clients in the development and implementation of their custom policies. A client's existing voting policy is initially reviewed both by research staff and a dedicated custom policy team, in order to identify areas that require further discussion with the client before the custom policy is implemented. During the implementation process, the Glass Lewis custom policy team discusses the options that can be used to accommodate the client's specific approaches to various issues. Once the policy is fully developed, the client reviews a final implementation document to ensure that its policy is being implemented by Glass Lewis in a manner that is in line with the client's instructions. Throughout the year, custom policy managers monitor trends and developments in corporate governance and proxy voting, and will consult with clients to implement new approaches that are consistent with their policies. In addition, Glass Lewis conducts annual policy reviews with each custom policy client to further analyze the client's policy and discuss any developments that might result in modifications to the policy.

Both Glass Lewis and its investor clients have policies and procedures for monitoring the accuracy of proxy policy implementation and voting activity in order to ensure votes are being cast in accordance with client specifications. These reviews include but are not limited to spot audits throughout season, comprehensive audits post-season, and annual due-diligence visits by compliance personnel at the investor client that are independent of the people responsible for voting.

2. Are issuers being given an appropriate opportunity to raise concerns if they disagree with a proxy advisory firm's recommendations, including, in particular, if the recommendation is based on erroneous, materially incomplete, or outdated information?

Glass Lewis strongly believes its analysis, research and recommendations should be based on publicly-available information and encourages companies to provide comprehensive and clear disclosure about the relevant issues for consideration by shareholders.

In order to ensure the data Glass Lewis uses in the formulation of its proxy research reports is complete and factually correct, Glass Lewis has a resource center[1] on its website designed specifically for the issuer community via which public companies, their directors and advisors can, among other things: (i) submit company filings or supplementary publicly-available information; (ii) participate in Glass Lewis' Issuer Data Report ("IDR") program, prior to Glass Lewis completing and publishing its analysis to its investor clients; and (iii) report a purported factual error or omission in a research report, the receipt of which is acknowledged

[1] http://www.glasslewis.com/issuer-overview/

immediately by Glass Lewis, then reviewed, tracked and dealt with internally prior to responding to the company in a timely manner.

Glass Lewis's IDR program allows issuers to request, and be provided with, a data-only version of its research report, free of charge. The IDR is made available to issuers prior to Glass Lewis completing the analysis that is based on that data. This review process enables issuers to notify Glass Lewis of any factual mistakes in the publicly-available data we have collected from issuers and third-party sources, prior to our completing and publishing the analysis for our investor clients. The IDR service is available to all issuers that sign up for the IDR prior to releasing their proxy materials for the relevant meeting.

Moreover, if Glass Lewis is notified of a purported factual error or omission after a report has been published, we immediately review the report and, if there is a reasonable likelihood the report will require revision, we remove the report from its published status so no additional clients can access it. If a report is updated to reflect any new publicly-available disclosures by the issuer or the correction of a factual error, Glass Lewis notifies all clients that accessed the report or have corresponding ballots, regardless of whether the update affected any recommendations. There is no deadline for notification of a purported factual error or omission. Additionally, the exact nature of the report's updates and revisions are clearly described in the republished report. If an issuer notifies Glass Lewis of a relevant purported factual error or omission in a report, Glass Lewis' research team will respond and address the issuer's comments and/or questions.

Glass Lewis is committed to ensuring its Proxy Paper reports contain accurate information. Accuracy is reported independently of research teams on a companywide basis; is a key determinant in the performance assessment of analysts; and is strongly aligned with our competitive interests of retaining and winning clients. This accuracy and omission data is also made available to our clients and prospects as they exercise due diligence of our services.

3. Is there sufficient transparency about a proxy advisory firm's voting policies and procedures so that companies, investors, and other market participants can understand how the advisory firm reached its voting recommendations on a particular matter, and whether comparisons of recommendations across similarly situated companies have value?

Glass Lewis believes in being forthcoming with policies and procedures for analyzing companies on behalf of its clients. Therefore, the firm publicly discloses significant information about its research policies and approach[2], including our full U.S. guidelines, as well as the voting guidelines for other major countries[3]. The disclosure describes Glass Lewis' case-by-case approach to analyzing issues submitted for shareholder vote at company shareholder meetings

[2] http://www.glasslewis.com/understanding-our-compensation-analysis/
[3] http://www.glasslewis.com/guidelines/

and notes the firm's belief that each company should be evaluated based on its own unique facts and circumstances, including performance, size, maturity, governance structure, responsiveness to shareholders, domicile and stock exchange listing.

For example, Glass Lewis tailors its approach to each country's relevant regulations, practices and corporate governance codes and consults with Glass Lewis' Research Advisory Council[4], an independent external group of prominent industry experts, to ensure Glass Lewis' proxy voting policies are comprehensive, well-reasoned and reflective of current global governance and regulatory practices and developments. In addition, Glass Lewis engages and maintains an ongoing dialogue with a wide range of market participants, actively participates in panels, working groups and industry conferences, and revises and enhances its methodologies, at least annually, in response to regulatory developments, market practices and issuer trends.

Glass Lewis' public Statement of Compliance with the Best Practice Principles for Providers of Shareholder Voting Research & Analysis[5] (BPP) contains substantially more information about the Glass Lewis research approach and methods, including statistics on voting recommendations in conflicted situations or when a client is a shareholder proponent. The publicly-available Statement of Compliance also outlines how Glass Lewis develops its proxy voting policies.

Glass Lewis also recognizes that dialogue, at the appropriate time, with all issuers that wish to engage can foster mutual understanding, transparency and feedback with respect to Glass Lewis' policies, methodologies and analysis, as well as the unique circumstances that each issuer faces based on a multitude of factors (e.g., their size, industry, operations and maturity). Therefore, Glass Lewis is open to engaging with any issuer that wants to engage outside of the solicitation period.

In addition to issuers requesting meetings, Glass Lewis has an ongoing practice of proactively contacting companies globally. By way of example, in 2017 alone we contacted more than 13,000 companies (one-third of which are based in the United States and Canada), to provide them with free and comprehensive information on topics relating to Glass Lewis, including: (i) policy and guideline information; (ii) directions for how to sign up for the free IDR service; (iii) directions for how to request an engagement with Glass Lewis (always at no cost); and (iv) directions for how to provide feedback on Glass Lewis reports and policies.

Through this process, Glass Lewis engaged with more than 2,300 issuers in 2017, nearly half of which independently requested a meeting with Glass Lewis analysts. As a result, Glass Lewis conducted nearly 1,400 formal meetings with almost 1,100 issuers in person or by phone in 2017, many of which were with issuers that engage with Glass Lewis at least once annually.

[4] http://www.glasslewis.com/leadership-2/

[5] http://www.glasslewis.com/wp-content/uploads/2018/02/GL-Compliance-Statement-2018.pdf

GLASS LEWIS

Typically, these meetings focus on Glass Lewis' research policies and methodologies and participants' respective views on governance practices given the unique context of their companies. Glass Lewis declined 6% of meeting requests, as they breached our policy of not engaging with issuers during the solicitation period preceding the issuer's shareholder meeting (see below). Additionally, issuers withdrew 7% of meeting requests, as a meeting was no longer required following our response to their initial inquiry.

We believe that allowing an issuer to engage with us during the solicitation period may lead to discussions about the issuer's proxy, thereby providing issuers with an opportunity to lobby Glass Lewis for a change in policy or a specific recommendation against management. To ensure our research is always objective, Glass Lewis takes this added precaution and postpones any engagements until after the solicitation period has ended, with the below exception.

In the case of a dissident campaign, transaction or shareholder proposal, Glass Lewis may meet with the shareholder proponent or dissident during the solicitation period – but only if we afford the issuer the same opportunity. These meetings may provide our analysts with useful context given the unusual volume and timing of disclosures made during the solicitation period of these extraordinary shareholder meetings. As is always the case, however, it is important to reiterate that our analysis and recommendations are based solely on publicly-available information. In the event Glass Lewis does agree to hold such meetings, it makes full disclosure of this decision in the relevant Proxy Paper reports we publish.

During the solicitation period, issuers and clients can and do contact Glass Lewis to provide additional information and clarifications, or to allege an error or omission in any of our reports, via our online, auditable process for receiving, tracking and responding to such queries and notifications. Any issuer or client that contacts us regarding these matters will receive a timely response from our engagement team and, if appropriate, from the analyst(s) responsible for the relevant report. Glass Lewis' analysts may also use the same process to seek clarification from an issuer in the rare circumstance that its public disclosure is unclear. However, in furtherance of Glass Lewis' commitment to avoid any conflicts of interest, as well as to refrain from using non-public information, analysts are strictly prohibited from meeting privately with issuers during the solicitation period.

Engagement meetings are always held at no cost to the issuer company, shareholder proponent or dissident. This is in line with Glass Lewis' commitment to avoid any conflicts of interest.

4. Are proxy advisory firms adequately disclosing and mitigating conflicts of interest?

Glass Lewis has robust policies and procedures in place to help monitor, manage and address any potential conflicts that may arise in the course of its business. These conflict management policies and procedures, comprised of Glass Lewis' Conflict of Interest Statement[6], Conflict Management Procedures and Code of Ethics, were developed to support investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms, as detailed in SLB 20.

Glass Lewis eliminates, reduces and discloses – proactively, explicitly and comprehensively – potential conflicts, to the greatest extent possible.

For instance, Glass Lewis strongly believes that the provision of consulting services to corporate issuers, directors, dissident shareholders and/or shareholder proposal proponents, creates a problematic conflict of interest that goes against the very governance principles for which we advocate. As a result, Glass Lewis does not have a consulting business. This helps ensure that our voting recommendations and analysis are disinterested.

In addition, to ensure that Glass Lewis' Proxy Paper reports and vote recommendations are in no way influenced by its clients' voting strategies, Glass Lewis' research analysts do not have access to client holdings files, custom policies, and/or voting activity. Access to such information is strictly limited to the client services and operations team members directly responsible for supporting each client.

Moreover, Glass Lewis' Code of Ethics addresses personnel conflicts, confidential treatment of client information, insider trading, among many other topics. All Glass Lewis employees and agents, worldwide, must annually review and affirm their commitment to the Code of Ethics, as well as update Glass Lewis with information on (i) any reportable outside activities (e.g. other employment, involvement in investment clubs, etc.) or any other activities related to the securities industry or the business of Glass Lewis, and (ii) any ownership interest greater than 5% or any position (e.g. director, officer, or executive) the employee or agent, or any of his or her relatives, holds in a publicly-traded company. Glass Lewis' Compliance Committee regularly reviews the Code of Ethics and incorporates any revisions required by applicable laws, rules and regulations. In addition, the Senior Vice President and General Counsel, with the assistance of the Director of Compliance, monitors the disclosure of personal trading accounts, the pre-approval trading process, and all employees' and agents' quarterly personal trading reporting.

For any other potential conflicts of interest that may be unavoidable, Glass Lewis makes full disclosure to its clients to enable them the opportunity to understand the nature and scope of the potential conflict and make an assessment about the reliability or objectivity of the recommendation. This is done by adding a disclosure note to the front cover of the relevant proxy research report when Glass Lewis determines that there is a potential conflict of interest (e.g. related to Glass Lewis' ownership structure, business partnerships, client-submitted shareholder proposals, employee and outside advisors' relationships and when an investment manager client is a public company or a division of a public company).

[6] http://www.glasslewis.com/conflict-of-interest/

Relating to our ownership, Glass Lewis is a portfolio company of the Ontario Teachers' Pension Plan Board ("OTPP") and Alberta Investment Management Corp. ("AIMCo"), that operates as a company independent from its owners. In addition, OTPP and AIMCo are excluded from any involvement in the formulation and implementation of the Glass Lewis proxy voting policies and guidelines, as well as in the determination of voting recommendations for specific shareholder meetings. Moreover, in the event Glass Lewis publishes a Proxy Paper report on a company in which OTPP or AIMCo: (i) holds a stake in the company significant enough to be publicly announced in accordance with such company's local market regulatory requirements; or (ii) is a dissident shareholder in a proxy contest or a shareholder proposal proponent, Glass Lewis adds a prominent disclosure note on the relevant Proxy Paper report.

In addition, in order to ensure any potential new conflicts are addressed appropriately and communicated to clients in a timely manner, Glass Lewis' Compliance Committee – comprised of Glass Lewis' Chief Executive Officer; Chief Operating Officer; Senior Vice President of Research and Engagement; Senior Vice President and General Counsel; and Director of Compliance – meets on a quarterly basis.

5. What is the appropriate regulatory regime for proxy advisory firms and should prior staff guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms be modified, rescinded, or supplemented?

Since the SEC issued the 2010 Concept Release on the U.S. proxy system, Glass Lewis has been actively engaged with regulators, investors, issuers and other stakeholders across the globe regarding the role of proxy advisors. In responses to three subsequent consultations, issued in 2012 by the European Securities and Markets Authority ("ESMA"), Canadian Securities Administrators ("CSA") and the Corporations and Markets Advisory Committee of Australia ("CAMAC"), Glass Lewis has consistently expressed the view that a market-based solution, in particular a code of best practices developed by proxy advisors, is the appropriate means to address the relevant issues raised in these consultations – namely conflict management, transparency of policies and methodologies, and engagement.

In 2013, after its consultation, ESMA published its final report containing the analysis of the results of the study, in which it stated that it did not see a need for binding or quasi-binding regulation. Further, ESMA said the "appropriate approach" was for the industry to develop a code of conduct, to be applied on a comply-or-explain basis, that would address two areas of concern raised in the public consultation: 1) identifying, disclosing and managing conflicts of interest and 2) fostering transparency to ensure the accuracy and reliability of the advice. Glass Lewis, ISS and the leading providers in the UK (Manifest and PIRC), France (Proxinvest) and IVOX (a Germany-based firm that was acquired by Glass Lewis in 2015) formed the Best Practice Principles group to develop a code of conduct ("Principles") for the industry, which the signatories to the Principles said they would apply globally. Similar to the practice for nearly all

GLASS LEWIS

industries, the participants in the industry, i.e. the proxy advisors, took the lead in drafting the Principles to which they would be subject but in consideration of input from ESMA and other stakeholders, including numerous issuer respondents to the consultation from both Europe and North America. Following a global, public consultation regarding the proposed Principles, the final Principles were officially launched in March 2014. And, in 2017, the charter signatories to the Principals conducted another public consultation to elicit market feedback on the extent to which the Principles are achieving their original objectives and to identify opportunities for improving understanding and transparency. An advisory panel, comprised of stakeholders from companies, asset owners, asset managers and other constituencies, provided input to the preparation of the consultation under the guidance of an independent chairman. Among other things, the latest update to the Principles will address the transparency requirements for proxy advisors outlined in the EU DIRECTIVE 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and due for implementation in Member States by June 2019.

Since the launch of the Principles, Glass Lewis and the other charter signatories to the Principles have each published their Statements of Compliance, featuring detailed information on how the organizations comply with the Principles and all the related Guidance. Glass Lewis applies the code to its activities globally, including in the United States. Glass Lewis updates its Statement of Compliance annually.

Glass Lewis believes that requiring proxy advisory firms to register as investment advisers under the Investment Advisers Act of 1940, as the framework stands today, would provide little or no protection to investors and issuers with respect to the areas of concern that have been raised. The existing framework was not originally designed to oversee and monitor the nuanced activities of a proxy advisory firm but was tailored with the investment advisor in mind. Proxy advisors neither advise their clients whether to purchase, sell or hold securities nor do they manage client investments. For a more detailed legal explanation on this, please refer to the Memo prepared by our outside counsel, Willkie Farr and Gallagher LLP, on "Glass Lewis Status under the Investment Advisers Act of 1940," attached here as Attachment 1.

While we can argue that proxy advisors are already subject to various provisions of the federal securities laws and regulations, depending on the nature of their activities, as well as to implied standards of conduct, such as the Principles, we understand the call for a more formalized approach to oversight. In our view, however, validating the standards of conduct already implicitly enforced by the industry, which are based largely on policies and procedures proxy advisory firms already have in place, coupled with a mechanism to monitor and ensure compliance, would be a more appropriate way to address the issues around the role of proxy advisors, conflicts of interest, accuracy and reliability, transparency, and increased oversight. This approach would not only be more aligned with the nature of the industry but would also serve in the best interest of all market participants.

GLASS LEWIS

Roundtable Topics Related to the Proxy Process

In our October 18, 2010 comment letter regarding the SEC Concept Release on the U.S. Proxy System, we outlined two important areas of discussion. Specifically, the availability of vote confirmations and the disclosure of agenda items in advance of the record date. Both of these topics remain pertinent to investors as does the universal ballot and the criteria used to assess shareholder proposals.

1. Vote Confirmations

We believe investors are entitled to receive confirmation that the correct number of shares was tabulated and that the voting on each proposal was in accordance with the shareholder's instructions. Vote confirmations would affirm the integrity of the vote and reinforce the importance of voting. Admittedly, there are factors that make vote confirmations a complicated process. However, there are already instances where confirmations are being provided to investors today, so we believe the complicating factors can be readily overcome if the appropriate incentives exist for the various intermediaries involved in the voting process. In return, a fully transparent and accurate voting system would significantly strengthen the value of, and therefore shareholder care applied to, proxy voting.

We recognize that vote confirmations are made more challenging by the number of entities in the chain of intermediaries (e.g., investors, proxy advisors, ballot distributors, custodians, sub-custodians, depositaries, transfer agents, tabulators, etc.). This complexity is exacerbated by both the lack of standard account identifiers, since each intermediary may assign a different identifier to the same account, and the absence of a robust communication standard, making ballot reconciliation a resource-intensive, time-consuming and, occasionally, inexact exercise. We believe vote confirmation could be facilitated through the creation of an electronic tag for each account that could be followed through the chain of intermediaries. Using a unique identifying code provides the added benefit of allowing investors to retain their anonymity. Ideally, a central entity with no vested interest in the process, such as DTCC, could assign and manage the identification codes.

Additionally, new technologies, such as blockchain, could be very effective in solving the traditional challenges associated with providing accurate, timely and granular vote confirmations while also addressing concerns around over/under-voting, investor anonymity and distribution costs.

2. Advanced Disclosure of Agendas

We recognize that share lending is a valuable means of maximizing returns for investors as well as an important source of market liquidity. However, this practice results in a separation of economic and voting interest as investors lose their ability to vote any shares that are out on-loan. Ideally, investors should be able to assess the benefits derived from continuing to lend their shares versus those from recalling and voting their shares. Since recall decisions need to be made before record date and agendas are disclosed after record date, any meaningful assessment of the differences is virtually impossible. This leaves investors with three possible options: 1) don't participate in share lending; 2) participate and recall all shares; and/or 3) participate and don't recall any shares. These are all blunt solutions that might not be in the long-term, best interests of investors or issuers.

The easiest way to ensure shareholders have the opportunity to recall lent shares would be for issuers to provide full advance notice of their proposals prior to record date. We believe with adequate notification, shareholders would be armed with enough information to decide whether to recall their shares. Often the decision to recall shares on loan requires the input of several investment professionals, and once decided, the mechanics of the recall process generally takes several days. Therefore, public notice of the issues to be voted on should be made at least 14 calendar days prior to record date.

To address concerns about companies having sufficient time to provide information and, in some cases, await SEC decisions on no-action requests to exclude shareholder proposals, advanced notification could also be accomplished by moving the record date closer to the meeting date. However, setting the record date too close to the meeting can make it difficult to distribute meeting information to investors, especially retail investors receiving information via mail. Therefore, we believe the record date should be no closer than 21 calendar days prior to the meeting date. This timing, coupled with prior disclosure of agenda details, would ensure investors have enough time and information to recall shares; would provide issuers with sufficient time to finalize and distribute their meeting materials; and would allow investors to make thoughtful voting decisions in advance of voting deadlines.

3. Universal Ballots

The current system for contested meetings limits flexibility and increases voting complexity by forcing investors to choose between management and dissident nominees on separate proxy cards. There may be instances where investors believe that the best option for the long-term success of an issuer is to support a mix of management and dissident nominees. In theory, it is possible for investors to vote their shares in this manner, but the administrative hurdles and associated risk of vote rejections generally dissuade investors from pursuing this option.

Requiring the use of universal ballots for contested meetings would provide investors with the flexibility to vote for their choice of management and/or dissident nominees, potentially lower the costs associated with proposing a nominee, and dramatically simplify the mechanics of the voting process for these high-profile meetings by eliminating the need for two competing proxy cards.

GLASS LEWIS

4. Shareholder Proposals

The shareholder proposal process serves as an important outlet for shareholders to raise concerns with management and affect changes to a company's governance processes and policies. Shareholders, as the ultimate owners of the company, do bear the costs associated with management's consideration of a proposal and its inclusion in the proxy statement. However, in many instances, shareholders have ultimately benefited from these measures, which often promote decision-useful disclosure, board accountability, and/or the protection of shareholder rights.

The shareholder proposal process has resulted in positive externalities for many in the marketplace, as there have been a number of broad shifts in the governance profiles of U.S. companies as a result of the private ordering of certain shareholder rights. For example, after a court overturned a regulation that would have required all listed companies to adopt proxy access, shareholders submitted resolutions requesting that companies adopt this provision. As a result, more than 60% of S&P 500 companies now have adopted some form of proxy access.

The U.S. currently has relatively low thresholds for the submission of shareholder proposals. However, unlike certain other markets, the U.S. provides for important protections for companies that counterbalance the low ownership required to submit shareholder resolutions. In certain markets, companies have no recourse when they receive a proposal that inappropriately micromanages a company or otherwise fails to serve the best interests of shareholders. However, should such proposals be submitted at U.S. companies, the SEC provides an important protection to companies and their shareholders through the no-action process. This process effectively mitigates the potential of abusive proposals that could harm the long-term interests of companies and their shareholders. Similarly, although relatively low, existing resubmission thresholds have not posed a significant risk to companies or their shareholders as there is little evidence that proposals receiving minimal shareholder support are being resubmitted to companies on an ongoing basis.

In summary, our view is that the current hurdles and protections in place around the shareholder proposal process are working, and are sufficiently protecting both the interests of issuers and investors.

As outlined above, we believe that the proxy advisory industry has been very responsive to the needs of our institutional investor clients, but also to the interests of the issuer community. We share the same goal of ensuring investors have accurate, reliable and timely access to information so that they can fulfill their obligations as fiduciaries. As such, we have put extensive practices in place to ensure our analysis is based on data that is factually correct, there is sufficient public information on our research policies and methodologies, and we prevent, manage and disclose conflicts effectively. Ultimately this ensures that all proxy

GLASS LEWIS

decisions made by investors are well-informed and that all votes we submit on their behalf are cast in accordance with their specific instructions.

Glass Lewis appreciates the convening of this Roundtable and the opportunity to submit this statement.

Sincerely,

Katherine Rabin

Chief Executive Officer

cc: The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
Dalia Blass, Director, Division of Investment Management
William Hinman, Director, Division of Corporation Finance
Brent J. Fields, Secretary

WILLKIE FARR & GALLAGHER LLP **MEMORANDUM**

TO: Glass Lewis & Co., LLC

FROM: James Anderson
Richard Jackson

RE: Glass Lewis Status under the Investment Advisers Act of 1940

DATED: November 6, 2018

You asked us to provide a written analysis of Glass Lewis & Co. LLC's ("Glass Lewis") status under the Investment Advisers Act of 1940 ("Advisers Act") in connection with the upcoming Securities and Exchange Commission ("SEC") Staff Roundtable on the Proxy Process. Our analysis follows.

I. BACKGROUND

Glass Lewis is an independent governance services firm. Glass Lewis principally provides proxy voting research, analysis, recommendations and custom services to institutional investors. Glass Lewis' clients use its research primarily to help them form their proxy voting decisions. Clients also use Glass Lewis' research when engaging with companies before and after their shareholder meetings.

Glass Lewis' proxy research subscribers receive a publication called *Proxy Paper*. *Proxy Paper* features contextual, objective analysis and voting recommendations on all proposals contained in thousands of proxies for companies around the world. Glass Lewis' recommendations are based on its own analysis of each particular company's proposals. Glass Lewis does not tailor its proxy voting recommendations to the needs of any client, nor does Glass Lewis decide how any investor client will vote on any particular matter. Rather, Glass Lewis' subscribers decide for themselves how to cast their votes in accordance with their own proxy voting policies, which may or may not be consistent with Glass Lewis' recommendations on particular issues.

For clients that desire assistance in exercising their vote, Glass Lewis administers a Web-based vote management system through which clients may receive, reconcile and vote proxies according to their own voting guidelines and record, audit, report and disclose their proxy votes. Glass Lewis also operates a share recall service which helps clients to evaluate the importance of upcoming shareholder meetings in order to determine whether to recall shares on loan in order to vote them.

Glass Lewis also publishes a number of other reports periodically. Recent examples include annual reviews discussing trends in shareholder voting, board composition, Glass Lewis recommendations and other areas; annual reports on key trends and case studies covering board elections, executive pay, ESG practices, shareholder activism, stewardship and engagement, and other notable trends in various markets; a review focusing specifically on shareholder proposals brought at U.S. companies; and a report on emerging best practices relating to disclosure of board skills.

Glass Lewis does not manage client investments and does not advise any client whether to purchase, sell or hold securities. Glass Lewis also does not provide consulting services to the companies it covers in its reports, although it does make its proxy research reports available to such companies post-publication.

II. ANALYSIS

A. Definition of "Investment Adviser"

Section 202(a)(11) of the Advisers Act defines "investment adviser" as

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . .

The SEC staff has stated that a person would be considered an investment adviser within this definition only if it falls within each of the three principal elements of the definition, *i.e.*, it (1) provides advice or analyses concerning securities; (2) is in the business of providing such services; and (3) provides such services for compensation.[1] We analyze each of these elements in the following subsections.

1. Advice or Analyses Concerning Securities

The SEC and its staff have taken a broad view of what constitutes advice or analyses concerning securities. Of course, advice or recommendations either about specific securities or about securities generally have been deemed to be advice concerning securities.[2] A person who advises a client concerning the relative advantages and disadvantages of investing in securities as compared to other types of investments also has been deemed to be advice concerning securities for purposes of Section 202(a)(11).[3] The staff also has taken the position that a person provides advice concerning securities if that person, in the course of developing a financial program for a client, advises the client as to the desirability of investing in, purchasing

---

1 *See* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Advisers Act Release No. 1092, 1987 SEC LEXIS 3487 (Oct. 8, 1987) ("Release 1092").

2 *See id.;* College Resource Network, SEC No-Action Letter (avail. Apr. 9, 1993).

3 *See, e.g.*, Release 1092, *supra* note 1; College Resource Network, SEC No-Action Letter (avail. Apr. 9, 1993).

or selling securities, as opposed to or in relation to any non-securities investment or financial vehicle.[4]

Glass Lewis provides advice to clients solely about voting proxies and the issues about which the proxies relate, such as corporate governance, executive compensation, and accounting practices. Glass Lewis also provides administrative and other ancillary services relating to voting and participating in class action settlements. Glass Lewis' reports focus on a company's financial statements, disclosures, corporate governance, financial performance, litigation risks, related party transactions, internal controls and accounting policies. The reports do not analyze a company's securities, or discuss whether investors should take any action in response to Glass Lewis' analyses, such as purchasing, selling or holding the company's securities. Glass Lewis' reports also are not personalized, *i.e.,* the reports are not tailored to address factors of concern to any client with respect to its investment objectives or guidelines.

Glass Lewis never makes any recommendation as to whether to purchase, sell or hold securities. Rather, Glass Lewis' reports analyze the issues presented for shareholder vote and make recommendations as to how shareholders should vote, without commenting on the investment merits of the securities issued by the subject companies. Glass Lewis does not provide advice as to the value of securities. From time to time, Glass Lewis may express a view about the adequacy of consideration offered in connection with a transaction as to which shareholders have been asked to vote, but any such view is in the context of a particular vote and does not address the merits of the securities as an investment. More specifically, Glass Lewis' analysis of the terms of a transaction typically focuses on the process followed by the company's board of directors in determining to enter into the transaction and recommend it to shareholders, the alternatives considered by the board, the analysis and advice provided to the board by its advisors, and the quality and extent of the disclosure provided to shareholders about these matters. While Glass Lewis also reports its own views of the economic terms of the transaction, it does so by analyzing whether the terms of the transaction are fair to shareholders. Glass Lewis reports on the board's consideration of various valuation measures that are applicable to the company, but does not independently determine a fair price for the company's securities or recommend that shareholders take any particular action other than voting for or against a proposal. Glass Lewis does not exercise investment discretion over client assets, nor does it have any responsibility for selecting which securities are to be purchased or sold by clients, or how to allocate investments among different types of securities or other assets.

The focus of Glass Lewis' reports is the companies they cover and the issues they submit to shareholders for voting, not the securities issued by such companies, and Glass Lewis' recommendations are limited to recommendations about how to vote. While this is the sole purpose of Glass Lewis' analyses and recommendations, it is possible that some subscribers may use Glass Lewis' reports for other purposes. Some subscribers may consider Glass Lewis' analysis of a company together with other information in deciding to buy or sell the company's securities. The fact that some subscribers may use Glass Lewis' reports in this way does not mean that the reports are investment advice. To hold otherwise would make a wide variety of

---

4 *See, e.g.,* Release 1092, *supra* note 1; Financial Strategies, Inc., SEC No-Action Letter (avail. Feb. 14, 1994).

reports and other materials published by trade associations, public interest groups and others investment advice regardless of their content, based simply on how their subscribers choose to use those materials. The fact that an individual chooses to invest in stock of an automaker based on an article in *Car and Driver* or *Consumer Reports* about the quality of their automobiles should not by itself result in those publications being deemed investment advice.

2. The "Business" Standard

The SEC staff interprets the phrase "engages in the business" broadly, asserting that giving advice need not be the principal business activity of the person, so long as it engages in this activity with some regularity. The staff has stated that

> Whether a person giving advice about securities for compensation would be "in the business" of doing so, depends upon all relevant facts and circumstances. The staff considers a person to be "in the business" of providing advice if the person: (i) holds himself out as an investment adviser or as one who provides investment advice, (ii) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction-based compensation if the client implements the investment advice, or (iii) on anything other than rare, isolated and non-periodic instances, provides specific investment advice. [5]

Regarding these three factors, we note first that Glass Lewis does not hold itself out as an investment adviser or as a firm that provides investment advice. Glass Lewis's subscriber agreements, website and marketing materials do not hold Glass Lewis out as providing investment advice or making investment recommendations. Rather, Glass Lewis consistently holds itself out as providing advice regarding the voting of proxies and associated corporate governance and accounting issues. Second, Glass Lewis does not receive a separate or "clearly definable charge" for investment advice. Subscribers to Glass Lewis' reports pay based on the number of reports they receive, with the incremental cost declining as a subscriber's consumption increases. For clients that enroll in Glass Lewis' ViewPoint proxy voting system, subscription fees are based on the number of accounts and the number of ballots cast by the subscriber. Third, as we have discussed above, Glass Lewis does not provide investment advice, either specific advice or otherwise. Glass Lewis provides advice only regarding the voting of proxies.

3. Compensation

The definition of investment adviser applies only to persons who provide investment advice about securities for compensation. The SEC staff has stated that the compensation element is satisfied by the receipt of any economic benefit, whether in the form of an advisory fee or some other fee relating to the total services rendered, commissions, or some combination of the foregoing.[6] Compensation could be in the form of a separate charge or fee

---

5 *See* Release 1092, *supra* note 1.

6 *See id.*

for advice, or there could be a single fee covering a variety of services, including investment advice.

As we noted previously, Glass Lewis is compensated for its reports either directly through subscription fees that are based on the number of reports a client receives, or as part of the fee the client pays for enrolling in the ViewPoint proxy voting system, as applicable. In neither case, however, is this compensation for investment advice. As discussed above, the content of Glass Lewis' reports is not investment advice, but instead consists of analyses of companies, their proxy voting proposals, and related matters such as corporate governance, executive compensation and accounting matters. The reports only provide recommendations as to the voting of shares of the companies covered, and do not purport to advise anyone about purchasing, selling or holding securities issued by such companies or about the value of such securities.

B. The Publisher's Exclusion

Based on the discussion above, we believe Glass Lewis should not be deemed to be in the business of providing investment advice within the meaning of Section 202(a)(11). Notwithstanding this analysis, if Glass Lewis were deemed an investment adviser, Glass Lewis still could rely on the exclusion for publishers contained in Section 202(a)(11)(D).

Section 202(a)(11)(D) of the Advisers Act excludes from the definition of investment adviser "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." In analyzing the scope of the publisher's exclusion, the United States Supreme Court has noted that "Congress was primarily interested in regulating the business of rendering personalized investment advice, including publishing activities that are a normal incident thereto."[7] Further,

> The [Advisers] Act was designed to apply to those persons engaged in the investment advisory profession -- those who provide personalized advice attuned to a client's concerns, whether by written or verbal communication. [footnote omitted] The mere fact that a publication contains advice and comment about specific securities does not give it the personalized character that identifies a professional investment adviser.[8]

The key terms used in the publisher's exception, "bona fide" and "of general and regular circulation," are not defined in the Advisers Act. The Supreme Court explained their meaning as follows. The Supreme Court stated that to be "bona fide," a publication should "contain disinterested commentary and analysis as opposed to promotional material disseminated by a 'tout.'"[9] A publication with a "general and regular circulation" would be offered to the public on a regular schedule, but would not include "people who send out bulletins from time to time on the advisability of buying and selling stocks" or "tipsters" promoting particular securities

---

7 Lowe v. Securities and Exchange Commission, 472 U.S. 181, 204 (1985).

8 Id. at 207-8.

9 Id. at 206.

investments.[10] The Court further stated that in determining whether a publication was "regular," the consistency of its circulation was less important than the fact that the publication was not timed to specific market activity or to events affecting or having the ability to affect the securities industry.[11]

Glass Lewis' reports clearly fall within the publisher's exclusion. Glass Lewis' proxy voting reports and recommendations and other reports on corporate governance, accounting and other matters are not personalized or tailored to meet any subscriber's investment objectives or other policies. Glass Lewis' reports contain disinterested analysis and voting recommendations, and they do not promote investment in securities generally, or in any particular company's securities. Glass Lewis' reports focus on what the firm believes to be in the best interests of shareholders of each of the companies it covers. Moreover, Glass Lewis does not provide consulting services to the companies it covers in its reports, which helps ensure that its voting recommendations and analysis are disinterested.

Glass Lewis' reports also are published on a regular basis. Glass Lewis does not base the publication time of its reports on any specific market activity or other events affecting securities. Glass Lewis publishes its proxy voting reports and recommendations whenever there is a proxy solicitation by one of the thousands of public companies it covers. Glass Lewis' other reports are published generally on a quarterly, annual or other periodic basis.

C. Policy

Apart from the definitional issues discussed above, there is no reason, as a matter of public policy and the purposes of the Advisers Act, to requiring a proxy advisory firm such as Glass Lewis to register as an investment adviser. When the Advisers Act was enacted in 1940, the House Report described the purpose of the Act as follows:

> The essential purpose of [the Advisers Act] is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful. The [Act] also recognizes the personalized character of the services of investment advisers and special care has been taken in the drafting of the [Act] to respect this relationship between investment advisers and their clients.[12]

In its 2010 Concept Release on the U.S. proxy system, the SEC outlined its principal concerns regarding the regulatory status and role of proxy advisory firms under the Advisers Act. These concerns were the following:

---

10 Id.

11 Id. at 209.

12 H.R. Rep. No. 2639, 76th Cong., 3d Sess., at 28 (1940).

- Conflicts of interest – the Commission expressed concern that the inadequate disclosure and management of conflicts of interest by proxy advisory firms could result in shareholders being misled and could impair informed shareholder voting;

- Accuracy – the Commission said that to the extent that proxy advisory firms develop, disseminate and implement their voting recommendations without adequate accountability for the accuracy of the information on which those recommendations are based, informed shareholder voting could be impaired; and

- Power – the Commission noted that some have argued that proxy advisory firms have too much power to influence shareholder voting without appropriate oversight and without having an actual economic stake in the issuers.[13]

Requiring proxy advisory firms to register as investment advisers under the Advisers Act would not be a necessary or appropriate way to address these concerns. In fact, registration as investment advisers, in and of itself, will provide little or no protection to investors with respect to these issues.

Regarding conflicts of interest, the Commission cited a 2007 report of the U.S. Government Accountability Office ("GAO") which noted that the most commonly cited conflict of interest for proxy advisory firms is the fact that some firms provide both proxy voting recommendations to investors and their investment advisers and consulting services to corporations relating to issues to be presented to shareholders or improving their corporate governance ratings.[14] Requiring all proxy advisory firms to register as investment advisers would be an overly drastic response to this issue. Not all proxy advisory firms provide consulting services to the companies they cover in their proxy voting advisory services, and the Commission has noted that there has been concern about the adequacy of the disclosures that proxy advisory firms that have so registered have provided to their clients regarding their consulting activities.[15] In this regard, the Commission requested comment regarding whether it should revise or provide interpretive guidance regarding the exemption for proxy advisory firms in Rule 14a-2(b)(3) under the Securities Exchange Act of 1934, which requires disclosure of "any significant relationship" the firm has with the issuer, its affiliates, or a shareholder proponent of a matter on which it provides voting advice, and specifically whether to require more specific disclosure regarding potential conflicts of interest. Glass Lewis has stated that it would support enhancing the disclosure requirement associated with Rule 14a-2(b)(3).

Glass Lewis provides several types of disclosures to its clients regarding relevant conflicts of interest. All clients receive Glass Lewis' written Conflict of Interest Statement, which describes its conflict of interest policies. This statement is also published on Glass Lewis'

---

13 *See* Concept Release on the U.S. Proxy System, Securities Exchange Act Release No. 62495 (July 14, 2010), at 114-26 ("Concept Release").

14 *See id., citing* GAO, "Corporate Shareholder Meetings – Issues Relating to Firms That Advise Institutional Investors on Proxy Voting" (June 2007), at 10-11.

15 *See* Concept Release, *supra* note 13, at 117-18.

website. Glass Lewis also has adopted and implemented written Conflict Management Procedures which are intended to help ensure that conflicts of interest associated with its proxy advisory activities are identified, managed and disclosed appropriately. Among other things, the Conflict Management Procedures require specific and prominent disclosure in its research reports of conflicts of interest involving issuers, Glass Lewis' parents, the Ontario Teachers' Pension Plan and Alberta Investment Management Corp., or shareholder proponents. For example, in cases where a Glass Lewis parent owns a significant stake in a company that Glass Lewis covers, Glass Lewis provides the following disclosure to its clients in a note on the relevant research report:

> Glass Lewis policy requires full disclosure to its customers of any potential conflicts of interest. Please be advised that Ontario Teachers' Pension Plan Board, one of Glass Lewis' owners, holds a stake in this company significant enough to be publicly announced in accordance with such company's local market regulatory requirements. For a complete copy of the Glass Lewis Conflict of Interest Statement, please visit www.glasslewis.com/conflict-of-interest/.

In addition, if one or both of Glass Lewis' owners is a dissident shareholder in a proxy contest or a shareholder proposal proponent, Glass Lewis will provide the following disclosure in a note on the relevant research report:

> The shareholder proponent of Proposal X is the Ontario Teachers' Pension Plan Board, one of Glass Lewis' owners.

Glass Lewis' Conflict Management Procedures also set forth Glass Lewis' policies intended to ensure the independence and objectivity of its analysis and recommendations. Glass Lewis provides a copy of its written Conflict Management Procedures to clients on request.

As we have noted above, Glass Lewis does not provide consulting services to issuers, which helps to ensure the independence of its advice. This is a key factor in Glass Lewis' ability to rely on the publisher's exception, as it ties closely to the issue of whether its publications are "bona fide" within the meaning of that provision as interpreted by the Supreme Court in *Lowe*. To the extent that the SEC believes proxy advisory firms that do consulting should be registered, proxy advisory firms that do not provide consulting services should be excluded from this requirement and only be required to register if they otherwise provide investment advice and cannot rely on an existing exception, such as that for publishers. Glass Lewis' policy against providing consulting services is reflected in its Conflict of Interest Statement and its Conflict Management Procedures.

The Commission noted that to the extent that proxy advisory firms may base their voting recommendations on flawed data or analysis, some concern has been expressed by issuers that there should be a process for correcting such mistakes, such as by permitting issuers to review drafts of the reports before they are published. The Commission further noted that proxy advisory firms are not currently required to have specific procedures in place to ensure that their research and analysis are materially accurate or complete before recommending a vote.[16] Requiring registration of proxy advisory firms is not an appropriate means to ensure greater accuracy in the firms' recommendations. There is nothing in the Advisers Act that addresses the quality or accuracy of advice given by investment advisers or the advisers' qualifications, nor has the Act ever been interpreted so in the absence of fraud. Somewhat to the contrary, registered investment advisers that refer to themselves as such in their brochures must state on the cover page of the brochure that registration does not imply any level of skill or training.[17]

Regarding the supposed power that proxy advisory firms have,[18] it is difficult to see how registration as investment advisers would provide an answer, and if so what that answer would be. The fact remains that Glass Lewis does not decide how to vote proxies for any client. The clients retain the right and power to vote their proxies, and they may or may not follow Glass Lewis' recommendations. In fact, many of the clients that receive Glass Lewis' voting recommendations are themselves subject to a fiduciary duty with respect to voting their proxies, so they have a duty to vote in the manner that they believe is in the best interest of their clients, regardless of Glass Lewis' recommendations. Thus, registration as an investment adviser would not have any effect on proxy advisory firms' ability to influence the results of shareholder votes.

Since registration as an investment adviser would not by itself resolve the concerns raised in the Concept Release about the role of proxy advisory firms, the SEC could address these concerns by proposing a safe harbor rule by which a proxy advisory firm could be exempt from registration as an investment adviser if it meets certain conditions. In addition to conditions needed to make sure the proxy advisory firm is not providing investment advice, such a rule could address potential conflicts of interest by, for example, prohibiting a firm relying on the rule from providing consulting services to the companies the firm covers, requiring the firm to adopt written policies and procedures regarding the misuse of material nonpublic information, and requiring the firm to disclose potential conflicts of interest to clients. In addition, a proxy advisory firm relying on such a rule could be required to adopt and implement written policies and procedures reasonably designed to ensure that its proxy voting recommendations are based on accurate information and to disclose these policies to clients.

III. CONCLUSION

Based on the facts and analysis set forth above, Glass Lewis should not be deemed an investment adviser as defined in Section 202(a)(11) of the Advisers Act. Changes to the facts or to the SEC or the SEC Staff's positions referenced herein could result in a different conclusion.

---

16 *See id.*, at 119.

17 *See* Form ADV, Part 2A, Item 1.C.

18 The GAO has examined recent studies, reports and other documentation and interviewed market participants and other stakeholders and found that they have mixed views about the extent to which proxy advisory firms influence proxy voting and corporate governance practices. *See* GAO, "Corporate Shareholder Meetings – Proxy Advisory Firms' Role in Voting and Corporate Governance Practices Issues" (Nov. 2016), at 15-19.

Investment Advisors Act of 1940 - Rule 206(4)-6
Institutional Shareholder Services, Inc.

September 15, 2004

Mari Anne Pisarri, Esq.
Pickard and Djinis LLP
1990 M Street, N.W.
Washington, DC 20036

Dear Ms. Pisarri:

In your letter dated September 15, 2004 on behalf of Institutional Shareholder Services, Inc. ("ISS"), you request that we elaborate on the guidance that we provided on May 27, 2004 to Egan Jones Proxy Services (the "Egan Jones Letter") concerning investment advisers that use the recommendations of independent third parties to vote client proxies.[1] You essentially request that we concur with your view that an investment adviser may determine that a proxy voting firm is capable of making impartial proxy voting recommendations in the best interests of the adviser's clients based on the procedures that the proxy voting firm has adopted and implemented to insulate the firm's voting recommendations from incentives to vote the proxies to further the firm's relationships with issuers ("conflict procedures").[2]

In the Egan Jones Letter, we indicated that, under certain circumstances, a proxy voting firm could be an independent third party for purposes of making proxy voting recommendations for an investment adviser's clients, even though the firm receives compensation from an issuer ("Issuer") for providing advice on corporate governance issues ("corporate services").[3] We explained, however, that an investment adviser could breach its fiduciary duty of care to its clients by voting its clients' proxies based upon a proxy voting firm's recommendations because the firm could recommend that the adviser vote the Issuer's proxies in the firm's own interests, to further its relationship with the Issuer and its business of providing corporate services, rather than in the interests of the adviser's clients.

In the Egan-Jones Letter, we stated that an investment adviser should obtain information from any prospective proxy voting firm to enable the adviser to determine that the firm is in fact independent, and can make recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients. We suggested that an investment adviser also obtain such information on an ongoing basis from any proxy voting firm that it employs. We also suggested that an investment adviser require a proxy voting firm to disclose to the adviser any relevant facts concerning the firm's relationship with an Issuer, such as the amount of the compensation that the firm has received or will receive from the Issuer.

You contend that a case-by-case evaluation of a proxy voting firm's potential conflicts of interest is not the exclusive means by which an investment adviser may fulfill its fiduciary duty of care to its clients in connection with voting client proxies according to the firm's recommendations. We agree. You believe that an investment adviser may instead determine that a proxy voting firm is capable of making impartial recommendations in the best interests of the adviser's clients based on the firm's conflict procedures.

Whether an investment adviser breaches or fulfills its fiduciary duty of care when employing a proxy voting firm depends upon all of the relevant facts and circumstances. Consistent with its fiduciary duty, an investment adviser should take reasonable steps to ensure that, among other things, the firm can make recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients. Those steps may include a case by case evaluation of the proxy voting firm's relationships with Issuers, a thorough review of the proxy voting firm's conflict procedures and the effectiveness of their implementation, and/or other means reasonably designed to ensure the integrity of the proxy voting process. The relevant facts and circumstances will dictate what steps an investment adviser should take in evaluating a prospective proxy voting firm.

When reviewing a proxy voting firm's conflict procedures, an investment adviser should assess the adequacy of those procedures in light of the particular conflicts of interest that the firm faces in making voting recommendations.[4] An investment adviser should have a thorough understanding of the proxy voting firm's business and the nature of the conflicts of interest that the business presents, and should assess whether the firm's conflict procedures negate the conflicts.[5] The investment adviser should also assess whether the proxy voting firm has fully implemented the conflict procedures.

We also note that a proxy voting firm's business and/or conflict procedures could change after an investment adviser's initial assessment, and any changes could alter the effectiveness of the conflict procedures and require the adviser to make a subsequent assessment. Consequently, an investment adviser should establish and implement measures reasonably designed to identify and address the proxy voting firm's conflicts that can arise on an ongoing basis, such as by requiring the firm to update the adviser of any relevant change in its business or conflict procedures.

Please note that we take no position in this letter regarding whether ISS' conflict procedures, as described in your letter, effectively ensure that its proxy voting recommendations to investment advisers are impartial. Nor do we take any position regarding whether an investment adviser should hire ISS as an independent third party to vote client proxies. The decision to hire ISS as an independent third party and, in particular, the assessment of the adequacy and effectiveness of ISS' conflict procedures rests entirely with the investment adviser. If you have additional questions, you may telephone John L. Sullivan, Senior Counsel, David W. Grim, Branch Chief, or Alison M. Fuller, Assistant Chief Counsel, at (202) 942-0659.

Very truly yours,

Douglas Scheidt
Associate Director and
Chief Counsel

Endnotes

[1] As we noted in the Egan-Jones Letter, an investment adviser may face direct and indirect conflicts of interest in voting its clients' proxies. An investment adviser could, however, demonstrate that its vote of its clients' proxies was not a product of a conflict of interest if the adviser voted the proxies in accordance with a pre-determined policy based on the recommendations of an independent third party. See Investment Advisers Act Release No. 2106 (Jan. 31, 2003) (adopting Rule 206(4) 6). See also Investment Company Act Release No. 25922 (Jan. 31, 2003) (adopting Rule 30b1-4 under the Investment Company Act of 1940).

[2] In your letter, you specifically request no-action relief under rule 206(4)-6 under the Advisers Act. That rule addresses the adoption, implementation and disclosure of proxy voting procedures that are reasonably designed to ensure that investment advisers vote client proxies in their clients' best interests. You do not, however, request relief from any requirement of the rule. Consequently, we will not respond to your request for no-action relief under the rule. In addition, as a matter of policy, we will not respond to inquiries as to whether any particular policies and procedures are reasonably designed to ensure that an investment adviser votes its clients' proxies in their best interest because those inquiries are factual in nature, and we are not in a position to ascertain, verify or evaluate the requisite factual information.

[3] We stated that the mere fact that the proxy voting firm provides corporate services and receives compensation from the Issuer for these services generally would not affect the firm's independence from an investment adviser for purposes of making voting recommendations concerning the Issuer's proxies for the investment adviser's clients.

[4] For example, when assessing a proxy voting firm's conflict procedures, an investment adviser should consider whether the procedures effectively (a) preclude the natural persons who make the firm's proxy voting recommendations from obtaining access to information about the firm's

business relationships with Issuers and (b) insulate those persons from direct or indirect influence by the firm's employees who know of those relationships.

In addition, an investment adviser should consider, among other things, evaluating the frequency with which the proxy voting firm recommends voting in favor of the management of Issuers that have engaged the firm to provide corporate services.

[5] As an example, an investment adviser should consider how the conflict procedures address a proxy voting firm's voting recommendation concerning an Issuer that makes payments to the firm for corporate services, which are the single largest source of revenue for the firm.

Incoming Letter

Pickard and Djinis LLP
Attorneys at Law
1990 M Street, N.W.
Washington, D.C. 20036

September 15, 2004

By Hand and Electronic Mail

Douglas J. Scheidt, Esq.
Associate Director (Chief Counsel)
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Mr. Scheidt:

We submit this letter on behalf of Institutional Shareholder Services, Inc. ("ISS") to request assurance that the Division of Investment Management will not recommend enforcement action to the Commission if a registered investment adviser determines the impartiality of an independent proxy voting firm based on the proxy voting firm's overall policies and procedures rather than on an examination of the firm's specific relationships with individual issuers. In particular, ISS seeks a no-action position to the effect that an adviser may satisfy its duty under Rule 206(4)-6 under the Investment Advisers Act of 1940 ("Advisers Act") to determine that an independent proxy voting firm is capable of making impartial recommendations in the best interests of the adviser's clients by examining the procedures that the proxy voting firm has adopted to insulate its voting recommendations from its relationships with issuers.

ISS is a registered investment adviser whose primary business is helping institutional investors meet their fiduciary responsibilities related to proxy voting. It does this by analyzing proxies and issuing informed research and objective vote recommendations for more than 10,000 U.S. and 12,000 non-U.S. shareholder meetings each year.[1] In addition, the company publishes proxy voting manuals, newsletters and proxy season reviews, and maintains various corporate governance databases.

Completely separate from its institutional business, ISS also serves the issuer community with a variety of corporate governance web-based tools, advisory services and publications that can assist issuers with executive and director compensation modeling, capital structure planning and understanding corporate governance best practices. ISS believes that supplying issuers with access to its corporate governance web-based tools, advisory services and publications benefits the firm's institutional clientele, because good corporate governance ultimately results in increased shareholder value. Nevertheless, ISS realizes that serving both institutional investors and issuers could create potential conflicts. ISS has adopted and follows policies and procedures to ensure that the proxy voting advice and services it provides to institutional investors remain independent from the products and services it offers to issuers. These policies and procedures are fully disclosed to ISS' clients.

First, ISS has erected a firewall between its institutional and corporate activities in order to maintain the highest level of objectivity in research and integrity in voting recommendations. This firewall involves functional, physical, and technological separations. For example, the management and staff of the Domestic and Global Research departments who analyze proxies and formulate voting recommendations are completely different from the management and staff of the Corporate Programs division who supply the web-based tools and publications to corporate clients and provide advice in connection therewith. The sales staffs for the institutional and corporate products are distinct as well.

The Domestic and Global Research staff and the Corporate Programs staff operate out of separate and secure areas at ISS' headquarters, and they maintain separate and secure office equipment and information databases. Furthermore, both the Corporate Programs staff and the sales staff for the corporate products have been trained in the requirement to keep the identities of the issuer clients confidential, and they communicate with those clients in a secure fashion. ISS has also instituted a "blackout" policy pursuant to which the Corporate Programs division refrains from providing any advisory services to issuers or access to the web-based tools from the time a definitive proxy statement is filed and until the date of the issuer's shareholders' meeting.

In addition to its elaborate firewall, ISS has taken other steps to ensure the objectivity and transparency of its proxy voting advice. For example, ISS publishes a Proxy Voting Manual that describes all of the company's policies and the analytical framework it uses to make voting decisions on every major issue. By articulating these policies and analytical framework and requiring that all proxy analyses and vote recommendations be formulated in accordance therewith, the Manual ensures that each individual proxy analysis and voting recommendation is made on an objective basis. Furthermore, ISS requires issuers who buy products and services from the Corporate Programs division to sign an agreement acknowledging that their acquisition of such services will not result in their proxy proposals' receiving preferential treatment from ISS.[2]

Believing that sunlight is the best disinfectant, ISS also informs its institutional clientele about its business relationships with issuers in a number of different ways. For example, Part II of ISS' Form ADV contains a comprehensive narrative description of all the products and services that ISS makes available to corporations. Similar comprehensive disclosure appears on ISS' website.[3] In addition, the standard Master Services Agreement ISS uses with its institutional clients clearly discloses both that ISS' Corporate Programs Division offers products and services to issuers of proxy solicitations and that the Corporate Programs Division employees are not involved in the analysis of filed proxy proposals or the preparation of vote recommendations.

Finally, ISS discloses the existence of its corporate relationships on each proxy analysis, and it does so in a way that protects the sanctity of the firewall:

> *This issuer may have purchased self-assessment tools and publications from ISS, or ISS's Corporate Programs Division may have provided advisory or analytical services to the issuer in connection with the proxies described in this report. Neither the issuer nor any Corporate Programs Division employee played a role in the preparation of this report. To inquire about any issuer's use of ISS Corporate Programs products please email disclosure@issproxy.com.*

ISS affords institutional subscribers the opportunity to inquire about ISS' specific relationship with any individual issuer rather than merely publishing that information, because publicly identifying corporate clients would tip off the proxy analyst as to those relationships, thereby raising the very conflict that the company's information barrier is designed to avoid.

For the reasons discussed below, we respectfully submit that an adviser who subscribes to ISS' Proxy Advisory Services could sufficiently assess ISS' ability to render impartial voting advice on the basis of the firewall, general disclosure and other policies and procedures described herein without inquiring about specific issuer relationships on a case-by-case basis.

DISCUSSION AND ANALYSIS

As fiduciaries, investment advisers owe their clients duties of care and loyalty regarding all activities they undertake on their clients' behalf.[4] Last year, the Commission adopted Rule 206(4)-6 under the Advisers Act to address advisers' fiduciary duties in the context of proxy voting.[5] Among other things, this rule requires an investment adviser who has authority to vote client proxies to adopt and implement written policies and procedures reasonably designed to ensure that the adviser votes those proxies in the clients' best interest.[6]

The required policies and procedures must specifically describe how the adviser addresses material conflicts between its interests and those of its clients with respect to proxy voting. However the rule does not dictate the way in which advisers must address conflicts; nor does it include a list of approved procedures. Instead, the Commission recognized that because advisers come in so many shapes and sizes, the public is best served if advisers have the flexibility to craft procedures tailored to their operations and the particular conflicts they face.

While declining to specify how an adviser must address conflicts of interest, the Commission, in the Adopting Release for the rule, did discuss a number of options an adviser might consider. These include disclosing conflicts and obtaining client consent before voting; having the client engage another party to vote a proxy involving a material conflict; voting securities based on a pre-determined policy, where application of that policy to the matter in question leaves the adviser little discretion; or voting in accordance with a pre-determined policy based on the recommendations of an independent third party. To these options, the Commission added:

> *Other policies and procedures are also available; their effectiveness (and the effectiveness of any policies and procedures) will turn on how well they insulate the decision on how to vote client proxies from the conflict.*[7]

In a May 27, 2004 interpretive letter to Egan-Jones Proxy Services the staff of the Investment Management Division addressed the circumstances under which a third party may be considered "independent" for purposes of Rule 206(4)-6. In particular, the Egan-Jones letter confirmed that a third-party voting service's independence is determined by its relationship to the adviser who hires it to vote client proxies, not by its other business relationships. Thus, the "mere fact that the proxy voting firm provides advice on corporate governance issues and receives compensation from the Issuer for these services generally would not affect the firm's independence" for purposes of Rule 206(4)-6.[8]

However, the interpretive letter went on to explain that in order to satisfy its fiduciary duties, an investment adviser must undertake some due diligence before deciding to follow the voting recommendations of an independent proxy voting firm. In this regard, the adviser must obtain sufficient information to determine, among other things, that the independent voting firm has the capacity and competency to analyze proxy issues adequately, and that it is capable of making voting recommendations in an impartial manner and in the best interest of the adviser's clients. The adviser should also implement procedures to identify and address any conflicts regarding the third-party voting service that can arise on an ongoing basis.

Where an independent voting agent receives compensation from issuers for providing advice on corporate governance matters, the letter suggests various steps an investment adviser could take to ascertain that the agent is still able to make impartial voting recommendations in the best interests of the adviser's clients. These steps include requiring the voting agent to disclose information about its corporate governance activities on an issuer-by-issuer basis, or allowing the independent third party to vote the proxies of only those issuers with whom it has no material relationship. Although the staff did not indicate that these steps were the exclusive means by which an investment adviser could satisfy its fiduciary duties to its clients, some parties have, unfortunately, read the Egan-Jones letter that way.

As noted above, in adopting Rule 206(4)-6 the Commission opined that an adviser can address conflicts of interest in a variety of ways, and that the effectiveness of an adviser's policies and procedures depends on how well they insulate the proxy voting decision from the conflict in question. This means that an adviser can make a determination of an independent proxy voting agent's ability to render impartial advice based on the independent proxy voting agent's policies and procedures to insulate its voting recommendations from its relationships with issuers, without inquiring about the firm's relationships with issuers on a case-by-case basis.

CONCLUSION

Based upon the foregoing, we ask for your assurance that you will not recommend that the Commission take enforcement action for a violation of Rule 206(4)-2 under the Advisers Act if a registered investment adviser determines the impartiality of an independent proxy voting firm based on the proxy voting firm's overall policies and procedures rather than on an examination of the proxy voting firm's specific relationships with individual issuers. If you need any further information on this matter, please do not hesitate to contact me or William D. Edick at 202-223-4418.

Very truly yours,

Mari-Anne Pisarri

cc: John M. Connolly

Endnotes

[1] ISS also votes, records and generates voting activity reports for approximately one-half of its institutional shareholder client base.

[2] In fact, approximately 25 percent of all issuers who use ISS' products or services subsequently submit proposals that receive a negative recommendation from ISS' Proxy Advisory Service.

[3] www.issproxy.com. The home page for this site clearly identifies "Solutions for Institutional Investors" and "Solutions for Corporate Issuers."

[4] See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963).

[5] See IA Rel. No. 2106 (Jan. 31, 2003) (the "Adopting Release").

[6] The rule also obligates advisers to disclose information about those policies and procedures to clients and to inform clients how they can obtain information regarding how the adviser has voted their proxies.

[7] Adopting Release at section II.A.2.b.

[8] Egan-Jones Proxy Services at 3.

http://www.sec.gov/divisions/investment/noaction/iss091504.htm

November 13, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Rule 14a-8 and Proxy Process Reform

Dear Chairman Clayton:

We, the undersigned investors, representing total assets under management of almost $570 billion, respectfully write to express our views about the importance and benefits of shareholder proposals and proxy voting, and to urge the Securities and Exchange Commission ("SEC") to maintain Rule 14a-8 (the "Rule") as is. We appreciate the opportunity to comment on these matters prior to the SEC's upcoming Roundtable on the Proxy Process on November 15.

We believe that the current rules and thresholds under Rule 14a-8 work well for investors and issuers, and should be maintained. Under Rule 14a-8, a company is required to include shareholder proposals from eligible shareholders in its proxy materials unless the proposals do not meet the eligibility and procedural requirements of the Rule or are subject to exclusion on other bases as set forth therein. Shareholders who rely on the Rule may submit only one proposal per corporate annual meeting and are required to have continuously owned at least $2,000 in market value, or 1%, of an issuer's outstanding voting securities for a year or more by the date the proposal is submitted.

Currently, there are a number of bases upon which a company may rely to exclude shareholder proposals, including the provision of the Rule that governs the resubmission of such proposals. Pursuant to this provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the proposal may be excluded for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third.[1]

Critics of the benefits of shareholder proposals and the manner in which Rule 14a-8 has effectively governed the proposal process express various arguments purporting to justify unnecessary reforms and prohibitive requirements. These proposed new requirements would restrict shareholders' ability to put forth and vote on important proposals. However, the arguments used to justify these new restrictions do not withstand scrutiny.

[1] 17 C.F.R. § 240.14a-8(i)(12).

Shareholder Proposals Should Remain Open to Investors of All Sizes

Some critics argue that the SEC makes it too easy for shareholders to submit a proposal. Currently, a shareholder owning $2,000 worth of a company's shares for at least one year is permitted to submit a shareholder proposal. While at one time, ownership of a single share of stock came with the right to submit a proposal, in 1983 the SEC decided it made sense to have a modest but still low requirement, setting the threshold at $1,000 held for at least one year. The SEC in 1998 raised this to $2,000, "to adjust for the effects of inflation," but did not raise it further "in light of rule 14a-8's goal of providing an avenue of communication for small investors."

Such a requirement helps to ensure that smaller, 'Main Street' investors have the same rights to file a proposal as wealthier individuals and institutional investors. As such, the filing threshold ensures a form of shareholder democracy that is open to nearly all investors, as it should be.

Shareholder Proposals Cannot Currently be Re-submitted Too Easily

Critics of Rule 14a-8 suggest that resubmission thresholds should be raised to reduce the number of proposals filed repeatedly for a number of years. The data, however, do not support that re-filings are a problem. According to Institutional Shareholder Services ("ISS") data, from 2010 to 2017, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years. This affected only 26 companies.[2] In other words, resubmission of proposals receiving less than 20% support for a third or fourth time is very rare. Moreover, the current resubmission thresholds create significant pressure on shareholder proponents and a higher threshold would put a high percentage of proposals at risk for exclusion from proxies. The ISS database tracked 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017. Of these proposals, 104 proposals (22.7%) received less than 10% of the For/Against vote. In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.[3]

Experience indicates that it often takes several years for a proposal regarding an emerging issue to gain enough traction with investors to achieve double-digit votes. In many cases, these proposals eventually receive substantial support, leading to widespread adoption by companies.
For example, in 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.[4] The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

---

[2] ISS Voting Analytics database.

[3] Ibid.

[4] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013

Shareholder Proposals are Not Abused by Activist Investors

Abuse of the proposal process by alleged activist investors is another misguided argument used in favor of restricting shareholders' rights. According to this allegation, a small number of activist investors abuse the system by accounting for a disproportionate volume of proposals. While the ISS database does show that the Chevedden, Steiner, and McRitchie families submitted 14.5% of the 11,706 proposals filed between 2004 and 2017, *the average vote on these proposals was 40%.*[5] This average vote level indicates that these filers provide a valuable service to fellow shareholders by promoting good corporate governance. For example, these investors frequently focus on encouraging companies to adopt best-practice corporate governance reforms such as eliminating supermajority voting requirements, appointing an independent board chair, eliminating staggered boards, and giving shareholders a "say on pay" and "proxy access" to nominate candidates for board elections.[6]

Shareholder Proposals Are Not the Cause of the Reduction in Public Traded Companies

Only a small proportion of proposals are filed at companies with a recent IPO -- less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.[7] Because large companies make up a larger portion of investors' equity portfolios than small companies, larger companies are more likely to receive shareholder proposals. According to the ISS Voting Analytics database, S&P 500 companies received 659 proposals in 2017, which was equal to 77% of the 852 proposals that Russell 3000 companies received.[8] Moreover, only 3.7% of shareholder proposals in the ISS database were filed at companies with a market capitalization below $1 billion.[9]

There are numerous factors contributing to the reduction in the number of public companies in the U.S. According to Vanguard, these include:[10]

- a steep drop in the number of small and micro-firm IPOs compared with the number of IPOs during the tech bubble in the late 1990s. Vanguard explains: "It appears that companies are choosing to be acquired by larger public companies rather than go public themselves."
- In 2016, more than 4,800 private companies were acquired, compared with about 1,950 during the IPO peak in 1996.[11]
- Mergers are also the leading cause (and a generally growing proportion) of delistings.

---

[5] ISS Voting Analytics database.

[6] https://www.lexology.com/library/detail.aspx?g=b6ad9d24-4a68-4736-8b28-3bbbadfbd7f5

[7] ISS Voting Analytics database, and https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf

[8] ISS Voting Analytics database.

[9] Ibid.

[10] https://personal.vanguard.com/pdf/ISGPCA.pdf

[11] https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf

- Overall, Vanguard concludes that "the shrinking number of publicly listed companies consists almost entirely of those [micro] securities that would not have been invested in by active and passive funds anyway."

Vanguard also points out that growth in private equity is outpacing growth in public equity. Contributing to the growth in private funding of companies is a series of regulatory changes. The 1996 Securities Markets Improvement Act made it easier for private companies to sell stock to "qualified purchasers," meaning institutional investors and wealthy individuals.[12] In 2012 Congress boosted the allowed number of investors in large private firms from 500 to 2,000. The SEC also adopted rules to encourage "private placements," allowing private firms to raise millions of dollars while avoiding public reporting.[13] In addition, the growth in investment by mutual funds in late-stage private start-ups is providing resources that help companies delay going public.[14]

Due to these factors, among other macro forces such as low interest rates spurring debt financing,[15] private assets under management grew from less than $1 trillion in 2000 to more than $5 trillion last year. As a result, many companies no longer need an IPO to raise capital.[16]

At the same time, Wall Street fees for small company IPOs tend to be far higher than those paid by large companies. For example, Facebook paid around 1.1%, whereas many small companies pay roughly 7%.[17] SEC Commissioner Jackson labels these fees a "middle-market tax."[18]

These changes in market structure, and the deregulation of private investments, are far more important than shareholder proposals in reducing the number of public companies and offerings. In fact, there is no evidence that shareholder proposals are a factor in reducing IPOs, or in increasing the number of mergers, or companies going private.[19]

Shareholder Proposals Do Not Meaningfully Increase Costs

Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS database.[20] In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.

---

[12] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/
[13] Ibid.
[14] https://corpgov.law.harvard.edu/2017/09/28/the-evolution-of-the-private-equity-market-and-the-decline-in-ipos/ and https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf
[15] Ibid.
[16] Ibid.
[17] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/
[18] Ibod.
[19] https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf, p. 10
[20] Ibid.

Importantly, the cost to companies of the existing shareholder proposal process is generally low (and something companies have control over managing),[21] and the process often results in benefits to companies. As noted, most companies receive few, if any, shareholder proposals. In 2016, there were fewer than 1,000 total shareholder proposals filed at all reporting companies in the U.S.[22] Only half of the proposals submitted by shareholders appear in companies' proxies and, consequently, relatively few companies (fewer than 500 in 2016) held votes on issues submitted by shareholders.[23] This is in part due to meaningful dialogues that happen between investors and management that leads to win/win agreements - resulting in the withdrawal of resolutions. In any given year one quarter to one third of resolutions on environmental and social issues, for example, are withdrawn because of such agreements. And some governance issues like majority vote for directors and access to the proxy result in even higher rates of agreement, making a vote unnecessary.

Finally, the SEC oversees a robust "no-action letter" process that allows companies to exclude proposals from the proxy ballot that do not meet specific procedural or substantive hurdles.

Investors Benefit from the Valuable Services Proxy Advisors Provide to Advance Good Corporate Governance

Some argue that investors over-rely on proxy advisors ISS and Glass Lewis who account for 97% of market share in the industry. The alleged result is that ISS and Glass Lewis functionally control substantial voting shares of thousands of companies in their portfolios, and that this control empowers them to set standards for corporate governance by choosing which shareholder proposals to support.

In fact, while many institutional investors do rely on proxy advisors for advice and administrative help, voting decisions remain the ultimate responsibility of investors. As CII states in their letter to the House Committee on Financial Services, dated Nov 9, 2017:

> *"Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.*
>
> *In short, most large institutional investors vote their proxies according to their own guidelines. While large institutional investors rely on proxy advisors to manage the analysis of issues presented in the proxy statements accompanying over 38,000 meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.*

[21] The Dangerous "Promise of Market Reform": No Shareholder Proposals, Harvard Law School Forum on Corporate Governance and Financial Regulation, Adam Kanzer, 2017
[22] ISS Voting Analytics database.
[23] Ibid.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against say on pay proposals at 11.92 percent of Russell 3000 companies in 2017, only 1.28 percent of those proposals received less than majority support from shareowners.[24] *Similarly, although ISS recommended votes in opposition to the election of 10.43 percent of director-nominees during the most recent proxy season, just 0.185 percent failed to obtain majority support."*[25]

The Growth of Index Funds is Not Resulting in Too Much Power for Proxy Advisors

Another complaint posits that passive fund managers of index funds do not have the time or incentive to obtain the necessary information about each company whose shares are owned in their funds to be well-informed voters. According to these critics, this problem is becoming more pressing with the growth of index funds. Nearly one-third of equity investment in the United States is via index funds, and index funds are the largest shareholders in 40% of public U.S. companies.[26] As a result, critics claim that passive fund managers' reliance on the advice of proxy advisors cedes shareholder power to, functionally, two firms. As index funds continue to account for more and more of equity ownership, proxy advisors will continue to obtain even more influence over shareholder proposals.

Again, the critics' argument assumes that passive fund managers blindly follow the recommendations of the proxy advisors. These managers almost always have detailed proxy voting guidelines that frequently result in a divergence between their votes and the recommendations of the proxy advisors. For example in 2017, BlackRock and Vanguard voted for 2% of all climate-related shareholder proposals tracked by the non-profit organization Ceres, including many proposals that proxy advisors recommended voting for.[27]

Proxy Advisors Decrease Costs For Investors

Reliance on proxy advisers provides cost savings and market externality benefits to investors. Large, widely diversified institutional investors must manage proxy voting related to up to 38,000 annual meetings globally each year according to CII. Clearly, it is more efficient for most investors to rely on assistance from proxy advisors who can spread some of the costs of voting across thousands of clients than for each institutional investor to try to manage this herculean ask on their own. CII's November 9th 2017 letter to House Financial Services Committee[28] noted that...

---

[24] Ibid.

[25] ISS Voting Analytics Database (last viewed on Oct. 23, 2017 & on file with CII).

[26] Phil Gramm and Mike Solon, "Keep Politics Out of the Boardroom," WALL STREET JOURNAL, July 18, 2018.

[27] https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about

[28] https://www.cii.org/files/issues_and_advocacy/correspondence/2017/Attachment%20to%20December%2012,%202017%20Letter.pdf

... in recent months the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its recently issued report to the President on "A Financial System that Creates Economic Opportunities, Capital Markets." In that report, the Treasury found that 'institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements.' More importantly, the Treasury did not recommend any legislative changes governing the proxy advisory firm industry.[29]

Corporate Managers Benefit From Investor Input on Environmental, Social, and Governance Issues

One complaint argues that the shareholder proposal process is redundant because company management already considers environmental, social and governance (ESG) issues. However, if management already addresses a particular ESG issue set forth by the proposal, investors are far less likely to waste time filing the proposal in the first place, and the proposal can be challenged and rejected as "substantially implemented."

A second complaint concerns an alleged lack of connection between ESG issues and shareholder value. However, the Department of Labor has recognized that ESG issues can be significant:

[T]he Department merely recognized that there could be instances when otherwise collateral ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, these ordinarily collateral issues are themselves appropriate economic considerations, and thus should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments. In other words, in these instances, the factors are more than mere tie-breakers. To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.[30]

In addition, investors such as BlackRock, State Street and more than 1,700 members of the Principles for Responsible Investment have all publicly proclaimed the importance of ESG issues

[29] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets" 31 (Oct. 7, 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-CapitalMarkets-FINAL-FINAL.pdf.
[30] Field Assistance Bulletin 2018-01

to shareholder value.[31] These claims are backed by a robust set of academic research.[32,33] In fact, more than 20% of assets under management in U.S. markets are managed with some form of ESG strategy according to US SIF.[34] Clearly, ESG issues are frequently financially material.

The third and final concern relates to shareholder proposals that are redundant or overlap in content with other proposals filed with same company. In these cases, the SEC already serves as an impartial arbiter using specific guidelines. Under the existing Rule's framework, a company may request to exclude a shareholder proposal that (i) directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting; (ii) the company has already substantially implemented the proposal; and (iii) if the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting.

* * * * *

We do not believe revision of Rule 14a-8 is necessary at this time. The existing Rule currently allows institutional investors of all sizes and individual shareholders alike to engage corporate boards and senior management on their need to address important environmental, social, and governance issues and long-term risk management. Shareholder proposals frequently address emerging systemic risks to the U.S. and globally economies, such as the predatory lending that contributed to the 2008 financial crisis.

The current process also allows investors to communicate with boards, management, and other shareholders about the most effective, proactive way to protect investor interests with respect to corporate governance, risk, and policy issues affecting companies prior to a crisis.

As such, the existing process serves an important self-regulatory function for U.S. capital markets, allowing shareholders a means to protect their interests through a form of shareholder democracy. Additional government interference in this private ordering process is not necessary or advisable.

For these reasons, we oppose further restricting shareholder proposals, which are helpful to companies, investors, and the economy as whole. Thank you for considering these views. We welcome the opportunity to work with you to address these concerns.

Sincerely,

Addenda Capital
Adrian Dominican Sisters, Portfolio Advisory Board
Bailard, Inc
Bon Secours Mercy Health

---

[31] https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment

[32] https://responsiblebusiness.haas.berkeley.edu/research/moskowitz-past-winners.html

[33] https://www.ussif.org/performance

[34] https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf

Boston Common Asset Management
CCLA Investment Management
Christopher Reynolds Foundation
Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A.
Congregation of St. Joseph
Connecticut Retirement Plans and Trust Funds
Daughters of Charity, Province of St. Louise
Dignity Health
Educational Foundation of America
Friends Fiduciary Corporation
Green Century Capital Management
Impax Asset Management LLC
Inherent Group, LP
Interfaith Center on Corporate Responsibility
Loring, Wolcott & Coolidge
Maryknoll Sisters
Maryland State Retirement and Pension System
Maryland State Treasurer
McKnight Foundation
Mercy Investment Services, Inc.
Miller/Howard Investments, Inc
Oregon State Treasury
Parametric
Parnassus Investments
Progressive Investment Management
Seattle City Employees' Retirement System
Seventh Generation Interfaith, Inc.
The Episcopal Church USA
Tri-State Coalition for Responsible Investment
Trillium Asset Management
Trinity Health
Unitarian Universalist Association
USA West Province of the Society of Jesus
Walden Asset Management / Boston Trust

Cc: Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Pierce
Commissioner Kara M. Stein
Commissioner Elad L. Roisman

INVESTOR VOICE

INVESTOR VOICE, SPC
111 Queen Anne Ave N
Suite 500
Seattle, WA 98109
(206) 522-3055

DELIVERED VIA US | SIF,
THE FORUM FOR SUSTAINABLE AND RESPONSIBLE INVESTMENT

December 4, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs
U.S. Senate
Washington, DC 20510

Re: Hearing on Proxy Process and Rules; December 6, 2018

Dear Chair Crapo and Ranking Member Brown:

We write to provide comment to the House hearing on Proxy Process and Rules (the "Process"), that is scheduled for December 6, 2018. These comments echo those that Investor Voice submitted for the SEC Staff Roundtable on the Proxy Process, File No. 4-725. Investor Voice is an industry strategist and consultant, which in the past decade has advised public funds, mutual funds, and other institutional investors that collectively represent more than $223.7 billion in invested capital.

We are concerned about the Process, initially, because our observation is that the U.S. Securities and Exchange Commission ("Commission" or "SEC") has been pressed into this Process of evaluation under questionable pretenses. Specifically, the SEC's review appears to be largely in response to loud demands and unsupported assertions of the U.S. Chamber of Commerce (the "Chamber"), the Business Roundtable ("BRT"), the National Association of Manufacturers ("NAM"), and the so-called Main Street Investors Coalition ("MSIC") – each of which act with a decided conflict of interest both in regard to this matter, and in respect to the constituency that the SEC is mandated to serve.

In stark contrast, a number of the investors, institutions, and investor organizations that have thoughtfully commented on the SEC and House Process do, in stark contrast, have a mission that is aligned with – and serve clients or members who actually are – the constituency that the SEC has a legal mandate to serve.

Leaving aside for now any further commentary or analysis on how the SEC may have arrived at this divide (appearing to act in response to pressure from entities whose interests are counter to the Commission's established mission), Investor Voice will herein submit a select set of comments, and will be available to provide more in-depth commentary subsequently.

In brief, the Rule 14a-8 shareholder engagement process is a key stockholder ownership right which, for the vast majority of investors, is the only practical means of communication – whether with a company or with other investors. Rule 14a-8 (the "Rule") is a nuanced, thoughtful, and highly polished set of processes and procedures that well serve its original, intended, and proper constituency. What's more, it has faithfully and appropriately done so for quite a number of decades now.

We firmly believe there is no need to revise the existing rules that govern the proxy process... unless it would be to appropriately curb the obvious gamesmanship that is practiced by certain issuers, their outside counsel, and trade associations.

Six summary points:

1. **Ownership.** The $2,000 threshold is reasonable, and commensurate with a geometric line between its historical value and today's figure.
   - Chamber, BRT, NAM representations regarding 1% ownership thresholds are patently absurd, entirely self-serving, and would seriously damage the capital markets.

2. **Resubmission thresholds.** The 3%-6%-10% resubmission thresholds are also eminently reasonable. New issues take time to gestate and to form in the public consciousness – especially given the eight levels of structural bias† that exist against new issues when they appear on a ballot – and for multiple key reasons it is critical that time be allowed for this gestation to come to fruition:
   - The fact of the matter is that too often to count, keenly observant stockholders have served as an emerging-risk early warning system for fellow shareholders, boards of directors, and corporate management teams.
   - Risk avoidance equates with cost reduction, which equates directly with earnings enhancement.

3. **Cost.** In light of #2 above, the shareholder engagement process does not cost money; it saves and can even make money for companies wise enough to listen to the investor voice.
   - Even were one to blindly accept the absurd cost figures put forward by the Chamber, BRT, NAM, and MSIC, simply compare them to the exponential growth of corporate capitalizations, revenues, and executive pay packages.
     - ➢ The trajectory of shareholder engagement costs is so minor relative to market capitalizations that they may reasonably be deemed de minimis and inconsequential.
   - In addition, companies have at their disposal two excellent means of reducing if not eliminating the cost of engaging with shareholders:
     - ➢ They could talk to shareholders rather than thwart them, leading to the efficiency and potential profit enhancements noted in #2 above.
     - ➢ They may dismiss exorbitantly priced outside law firms and save untold sums in questionable legal charges.

continued on next page...

4. **Ownership rights.** Shareholder engagement is an essential right of stock ownership – it is part of the indispensable bundle of rights that accrue to stockholders. To arbitrarily curtail or eliminate that right would constitute a taking from stockholders, and cause irreparable harm to the capital markets system.

5. **Companies benefit.** Shareholders that engage with companies make them better, and shareholders who file large numbers of proposals make a larger number of companies better.

    - However, with conflicts of interest firmly in place, the Chamber, BRT, NAM, and MSIC categorically charge 'abuse' against small active shareholders whose proposals routinely earn majority votes, or a majority of independently voted shares (i.e., those voted outside of management control or influence).

        - The outstanding votes achieved by these filers should not be reviled – their success in persuading fellow shareholders (with only 500 words to do so) could more appropriately be described as democracy at its best. These activities should be encouraged and supported by the Commission and the House.

    - An essential fact is highlighted by the success that two small shareholders, in particular, have in filing and winning majority votes on sizable numbers of proposals. Their accomplishments underscore that the historical purpose of creating and perpetuating the Rule 14a-8 rights and procedures around shareholder engagement was to allow communication between shareholders.

        - Companies and their trade association forget this and have mistakenly complained that certain active shareholders do not talk with management; however, that was never the purpose of the Rule. While management does benefit from talking with its shareholders, shareholders retain every right to use the proxy process to communicate solely between themselves – without involving management if that is their choice.

6. **History.** Rule 14a-8 and the arena of shareholder rights originally arose under the rubric of shareholder protections. There was a reason these rights were created under law – to prevent the abuses that, decades ago, issuers visited upon stockholders.

    - However, in the intervening time human nature has not changed and corporate overreach has not been eliminated; in fact, nothing has changed to make redundant the necessary investor protections that these rights were purposefully created to ensure.

        - Large numbers of respected observers have commented that today there is likely to be more need for these protections and guidelines than in decades past. Investor Voice concurs with this assessment.

In closing

We appreciate the opportunity to comment, and stand ready to provide further input or to answer questions that may arise.

In the final analysis, we respectfully ask that the House firmly reject the self-interested posturing of the U.S. Chamber of Commerce, the Business Round Table, the National Association of Manufacturers, and the so-called Main Street Investors Coalition – each of which act at odds with the small investor that the SEC has a foundational purpose and mission to serve.

We urge the Commission to:

- **Consider** the points outlined above;
- **Remember** that the historic reason for and original purpose of the 14a-8 and related rules was to protect small investors;
- **Recognize** that the need for this purpose remains today; and
- **Reflect** upon the significant benefits that shareholder engagement of all stripes contributes to enlivening companies and to improving our capitalist system.

Then, with respect for how well prior Commissions have shepherded the Rule 14a-8 process through the years, please reaffirm the existing Rules as they are – so they may continue to serve the elevated and necessary purpose for which they were originally crafted.

In this light, the Rule's perpetuation constitutes a democratic trust that requires both care and attention in order to properly flourish. We have every confidence that the House and Commission will live up to this duty.

Sincerely,

Bruce Herbert

Bruce T. Herbert, AIF
Chief Executive and ACCREDITED INVESTMENT FIDUCIARY

† **Eight levels of structural bias against high votes on shareholder items.** See pages 6-7 of: http://www.newground.net/Docs/Financial-CHOICE-Act-Letter-2017.0426.pdf, excerpted here:

1. Management, founders, and descendants of founding families often own or control sizable portions of stock.
2. A majority of independent shareholders recycle their ballots and do not vote at all.
3. The major proxy reporting services (ISS, Glass Lewis) routinely recommend AGAINST shareholder proposals in their first few years of introduction.
4. Proxy ballots typically offer multiple opportunities to "vote with management on all items" (which will be AGAINST any shareholder proposal).
5. Management enjoys a decidedly powerful 'bully pulpit' when it comes to recommending a vote AGAINST shareholder items.
6. Under state law, companies are often allowed to choose a formula that disadvantages shareholder votes.
7. Shareholders are limited to 500 words in their shareholder proposals, whereas a company is not limited in the length of its Statement in Opposition.
8. Companies can track proxies as they come in, and can initiate special proxy solicitations.

ISS

Institutional Shareholder Services Inc
702 King Farm Boulevard Suite 400 Rockville, MD 20850
T: +1. 301.556.0500 | F: +1.301.556.0491

December 5, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of Institutional Shareholder Services Inc. (ISS), I want to thank you for the opportunity to submit this statement, as well as the enclosed documents, for the record in connection with the Committee on Banking, Housing, and Urban Affairs' (the "Committee") December 6 hearing on the "Proxy Process and Rules: Examining Current Practices and Potential Changes." We would like to take this opportunity to affirm our position on the role and value of proxy advisory firms, on the existing regulatory framework under which ISS operates and proposed legislative changes, as well as, generally, on the proxy system. For a more detailed and comprehensive discussion, please see the enclosed comment letter ISS submitted in connection with the Securities and Exchange Commission's (SEC) Roundtable on the Proxy Process on November 15, 2018, as well as the May 30, 2018, letter from Gary Retelny, President and CEO of ISS, to six Senators on the Committee.

The November 15 SEC Roundtable presented a diverse stakeholder perspective, yielding a thoughtful and productive discussion on the current system that enables shareholders to exercise their voting rights. This discussion carried into the third panel of the day which was dedicated entirely to proxy advisory firms. The third panel featured investment managers, including private firms and public pension funds, ranging in investment portfolio size; large and mid-cap corporate issuers; proxy advisory firms; as well as a corporate governance professor and a former Chairman of the Committee.

While there are critical, pressing issues within the proxy system that need to be addressed, particularly the proxy voting infrastructure, the audience at the SEC Roundtable heard broad stakeholder agreement that additional regulation of proxy advisers is not warranted. We note that when the Roundtable panel was explicitly asked to weigh in on the benefits and costs of additional regulation of the proxy advisory industry, no panelist urged a call to action. Indeed, investors, the primary consumers of proxy advisers' services, cautioned the SEC against additional regulation, reiterating their concerns about the resulting impact on the timeliness, independence, and increased costs associated with additional regulation of proxy advisers' work.

Moreover, and consistent with the 2013 SEC Roundtable on Proxy Advisory Services and, indeed, the June 28, 2018, Committee hearing on "Legislative Proposals to Examine Corporate Governance," we note that the November 15 discussion reiterated that:

1) Engagement and communication are central to the relationship between issuers and investors.

2) The fiduciary relationship between proxy advisers and their clients has, over time, proven to provide a highly reliable, cost-effective and efficient solution to the challenges of proxy voting.

Institutional Shareholder Services Inc.
702 King Farm Boulevard Suite 400 Rockville, MD 20850
T: +1. 301.556.0500 | F: +1.301.556.0491

3) Institutional investors rely on proxy advisory firms like ISS to provide independent research, data and analysis, as well as for operational ease and workflow management. This enables investors to fulfill their own fiduciary obligations to make informed, company-specific voting decisions on behalf of their clients.

4) Institutional investors are sophisticated, independent and informed consumers of proxy advisers' products and services. Institutional investors perform their own due diligence when determining which proxy advisory firm (or firms) to hire, if any, and subsequently when evaluating the performance of the proxy advisory firm they have employed.

5) Proxy advisory firms' work product is *just one of many inputs* that investors use to formulate their voting decisions. Many institutional investors have established their own proxy voting policies and guidelines. Institutional investors are committed to a diligent and conscientious approach to formulating proxy-voting decisions. They do not "outsource" their voting decisions, nor do they engage in "robo-voting" where the term is defined pejoratively to mean, "blindly following proxy advisory firms' recommendations."

For the reasons outlined in our prior statements, ISS continues to vigorously oppose H.R.4015, "The Corporate Governance Reform and Transparency Act." Amongst other provisions, the proposed legislation would mandate the right of issuers to pre-review and comment on proxy advisers' reports before they are provided to our clients, the group paying for that work product and to whom ISS owes its duties. This would significantly undermine our fiduciary responsibility to our clients, threatening the independence of our reports and infusing our operations with a new issuer-related conflict of interest. To be clear, the legislation, if enacted, would harm every shareholder who relies on independent research to make informed investment decisions.

We appreciate the Committee's attention to the proxy process and for the reasons articulated herein and in our referenced prior statements, we respectfully urge the Committee to steer away from "solutions in search of a problem" as it relates to proxy advisory firms and instead examine more pressing matters in the proxy process for which there exists strong, broad-ranging stakeholder support.

Thank you for considering our comments, and for the opportunity to have our views included in the hearing record. If I can answer any questions or provide any additional information, please do not hesitate to contact me.

Sincerely,

Steven Friedman
General Counsel

cc: Members of the Committee on Banking, Housing, and Urban Affairs

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

May 30, 2018

The Honorable Dean Heller
Chairman
Subcommittee on Securities, Insurance and Investment
Senate Banking, Housing, and Urban Affairs Committee
United States Senate
324 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Mike Rounds
Senate Banking, Housing, and Urban Affairs Committee
United States Senate
502 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Thom Tillis
Senate Banking, Housing, and Urban Affairs Committee
United States Senate
185 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Tom Cotton
Senate Banking, Housing, and Urban Affairs Committee
United States Senate
124 Russell Senate Office Building
Washington, D.C. 20510

The Honorable David Perdue
Senate Banking, Housing, and Urban Affairs Committee
United States Senate
455 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Tim Scott
Senate Banking, Housing, and Urban Affairs Committee
United States Senate
717 Hart Senate Office Building
Washington, D.C. 20510

Dear Senators Heller, Tillis, Perdue, Rounds, Cotton and Scott:

Thank you for your letter dated May 9, 2018. Institutional Shareholder Services Inc. (ISS) welcomes this opportunity to answer your questions, address common misinformation about ISS and proxy advisors, and provide clarity about our business practices and the regulatory requirements to which we are subject.

First, as a general note, ISS is a Registered Investment Adviser ("RIA"). As such, we are subject to the Investment Advisers Act of 1940 ("Advisers Act") and the rules and regulations that the U.S. Securities and Exchange Commission ("SEC") has promulgated thereunder. As an RIA, ISS owes a fiduciary obligation to our investor clients, which means ISS and our employees must carry out our duties solely in the best interests of clients and free from any compromising influences and loyalties. The Advisers Act and related SEC rules provide a mature and comprehensive regulatory regime that covers virtually every aspect of our business and that subjects ISS to the SEC's continuing oversight and examination authority. We must and do comply with these rigorous federal legal requirements. Being regulated under the Advisers Act also aligns us with our investor clients, many of whom are themselves also registered and regulated under the Advisers Act.

In this context, I am confident you will find that the Advisers Act effectively addresses many of your concerns.

Our response to your letter is organized as a direct reply to each statement and question you've posed (italicized):

➢ *"For years, your organization has significantly increased it[s] influence in shareholder voting practices, and between Institutional Shareholder Services (ISS) and Glass, Lewis & Company (Glass Lewis), you now control 97 percent of the of the [sic] proxy advisory industry..."*

ISS is indeed an industry leader in the corporate governance space and we are proud to have earned our market share by virtue of the quality of our work and the level of service we have provided for more than a quarter century. The GAO report entitled "Issues Relating to Firms that Advise Institutional Investors on Proxy Voting" concluded as much when it wrote that ISS has "gained a reputation with institutional investors for providing reliable, comprehensive proxy research and

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

recommendations."[1] While we have seen the widely circulated conjecture that two firms "control" 97% of the proxy advisory industry, this is not a statistic we have verified or can confirm.

There are no artificial barriers to entry into the proxy advisory industry in the United States. We operate in a competitive market and we have seen entrants come and go within the industry. Moreover, institutional investors are not required to purchase our services. In the free market, institutional investors purchase our services because they choose to do so, and find value in the products we provide.

We do, however, want to draw a distinction between our market leadership and your assertion that we influence "shareholder voting practices." ISS clients control both their voting policies and their vote decisions. ISS is generally not a discretionary proxy voting manager, except in rare situations where a client has an actual conflict of interest (for example, a financial institution that holds and must vote the shares of its parent company), and asks ISS to make a proxy voting decision on the client's behalf.

In fact, ISS is relied upon by our clients to assist them in fulfilling their own fiduciary responsibilities regarding proxy voting and to inform them as they make their proxy voting decisions. These clients understand that their duty to vote proxies in their clients' or beneficiaries' best interests cannot be waived or delegated to another party. Proxy advisors' research and vote recommendations are often just one source of information used in arriving at institutions' voting decisions. As participants in the SEC's 2013 Proxy Adviser Roundtable explained, many investors have internal research teams that conduct proprietary research and use proxy advisory research to supplement their own work.[2] Some investors use third-party proxy research as a screening tool to identify non-routine meetings or proposals. A number of institutional investors use the services of two or more proxy advisory firms. These views are consistent with the results of a 2012 survey of asset managers by Tapestry Networks that found proxy advisory firms' "role as data aggregators" has become increasingly important to asset managers, and that even if smaller managers are more reliant on such advisory firms, they still acknowledge that responsibility for voting outcomes lies with investors.[3] Said more simply, we are an independent provider of data, analytics and voting recommendations to support our clients in their own decision-making.

Moreover, in their paper, *The Power of Proxy Advisors: Myth or Reality?*,[4] University of Pennsylvania Law School Professor Jill Fisch, along with colleagues from New York University, analyzed the effect of proxy advisor recommendations on voting outcomes in uncontested director elections. The authors estimate that, after controlling for underlying company-specific factors that influence voting outcomes, far from being determinative of outcomes, an ISS recommendation appears to shift a very small percentage (6 to 10 percent) of shareholder votes, but that this influence may stem from ISS' role as information agent:

---

[1] Jones, Y. D. (2007). *Issues Relating to Firms that Advise Institutional Investors on Proxy Voting.* (GAO-07-765). Washington, DC: Government Accountability Office (hereafter, "2007 GAO Report") at 13.

[2] Remarks of Michelle Edkins, currently Managing Director, Global Head of BlackRock Investment Stewardship, BlackRock, Inc. Transcript of Proxy Advisory Firms Roundtable ("Roundtable Transcript"), available at www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt (December 5, 2013) at 45; remarks of Anne Sheehan, Director of Corporate Governance, CalSTRS, *Id.* at 153-54; remarks of Lynn Turner, Managing Director, LitiNomics, Inc., discussing his experience at Colorado Public Employees' Retirement Association, *Id.* at 51-52.

[3] Bew, Robyn and Fields, Richard, Voting Decisions at US Mutual Funds: How Investors Really Use Proxy Advisers (June 2012) at 2. Available at SSRN: http://ssrn.com/abstract=2084231. ("Across the board, participants in our research said they value proxy firms' ability to collect, organize, and present vast amounts of data, and they believe smaller asset managers are more reliant on those services. Nonetheless, participants emphasized that responsibility for voting outcomes lies with investors").

[4] Choi, Stephen J., Fisch, Jill E. and Kahan, Marcel, The Power of Proxy Advisors: Myth or Reality? 59 Emory L. J. 869 (2010); University of Pennsylvania, Institute for Law & Economics Research Paper No. 10-24. Available at SSRN: http://ssrn.com/abstract=1694535.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

> *[W]e find evidence that ISS's power is partially due to the fact that ISS (to a greater extent than other advisors) bases its recommendations on factors that shareholders consider important. This fact and competition among proxy advisors place upper bounds on ISS's power. Institutional Shareholder Services cannot issue recommendations arbitrarily if it wants to retain its market position. Doing so would lead institutional investors to seek the services of other proxy advisory firms.* ***Thus, ISS is not so much a Pied Piper followed blindly by institutional investors as it is an information agent and guide, helping investors to identify voting decisions that are consistent with their existing preferences*** *(emphasis added).*[5]

Many large institutional investors have their own customized voting and corporate governance principles that proxy advisory firms use as the basis for making tailored, client-specific vote recommendations for that particular investor. What this means is that a client with their own unique view of how to assess and vote upon proxy voting matters will look to ISS for assistance in the administration of their own customized proxy voting policy as opposed to using one of ISS' policy frameworks. As of January 1, 2018, approximately 85% of ISS' top 100 clients used a custom proxy voting policy. To provide further context, we note that during calendar year 2017, approximately 69% of the ballots processed by ISS on behalf of clients globally were linked to clients' custom policies, representing approximately 87% of the total shares processed by ISS during this period.

Moreover, in addition to both customized policies and our ISS "benchmark" proxy voting guidelines, ISS provides options for our clients in the form of multiple thematic, specialty policy options for investors who require a particular philosophical approach to proxy voting and corporate governance, including a policy set for faith-based investors and two focusing on social and environmental investing priorities. Again, the choice of which policy to use belongs to the client, not ISS. In other words, ISS does not have a monolithic view on proxy voting issues nor do we dictate how investors themselves think about these issues. Indeed, ISS has presented opposing recommendations on the same ballot proposal to different clients based on the differing policies/approaches of those clients and the proxy voting policies that they themselves select. In short, ISS provides investors with research, data and vote recommendations that enable them to implement their own proxy voting and corporate governance philosophies.

ISS is sometimes mislabeled as an "activist" organization. While the foregoing demonstrates that we are not, in fact, a monolith to which that or any similar label could apply, we think it is worth noting that for calendar years 2015, 2016 and 2017, under our "benchmark" policy guidelines, ISS recommended votes in support of the management position over 90% of the time (91.3%, 92.2% and 91.3% in each year, respectively).

As noted by the Council of Institutional Investors (CII), a leading nonpartisan and nonprofit association of public, corporate and union employee benefit funds and state and local entities with combined assets exceeding $3.5 trillion:

> Proxy advisory firm influence is exaggerated by analyses that confuse correlation with causation. ISS and Glass Lewis tend to follow investors on governance policy, not lead them. In setting their policy frameworks, the two firms have a business interest to ensure they reflect investor (client) perspectives, in part through extensive consultative processes, and to consider empirical evidence. Their franchises are built on credibility with investors. As a result, advisors' views reflect those of many funds. Indeed, if there were a sharp divergence, we would expect to see advisors punished in the marketplace.[6]

At the end of the day, institutional investors are not required to use proxy advisors' services or to use only one proxy advisory company, nor are they required to follow the vote recommendations of any proxy advisor they choose to use. The

[5] *Id.* at 906.

[6] June 13, 2016 letter from the Council of Institutional Investors to Rep. Hensarling, Chair of House Committee on Financial Services and Rep. Waters, Ranking Member of House Committee on Financial Services at 2.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

ultimate voting decision for each resolution at a company meeting remains the responsibility of our clients, the owners of the corporation, as we believe it should be.

Question 1 - ISS' Voting System

> *"We request that you provide detailed information on how the Proxy Exchange voting service works and why you think your company is in compliance with SEC Staff Legal Bulletin 20, especially in circumstances where each client does not have to formally approve or submit the pre-populated electronic ballot that you are producing for each shareholder meeting."*

Exchange Act Rule 14a-1(l) defines a proxy "solicitation" to include the "furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy."[7] The furnishing of a proxy pursuant to a security holder's unsolicited request is excluded from this definition.[8]

Both the SEC and its Staff have historically recognized the distinction between unsolicited and solicited proxy advice, applying the Exchange Act proxy rules to the former, but not the latter. For example, in a 1979 release, the SEC explained that, "As a general matter, unsolicited proxy voting advice would constitute a 'solicitation' subject to the proxy rules."[9] In making this observation, the SEC cited an earlier opinion of the SEC's General Counsel that addressed proxy advice in a broker-dealer context:

> In our view, a broker normally is not engaged in solicitation where he merely responds, whether orally or in writing, to an unsolicited request from a customer for advice as to how to vote. Since the broker is merely responding to his customer's request for advice in his capacity as adviser to the customer and not actively initiating the communication, it may be concluded that he is not engaged in 'soliciting.'[10]

Unfortunately, the longstanding regulatory distinction between unsolicited and solicited proxy voting advice has been blurred as a result of more recent Staff guidance. In addressing the interplay between proxy advisory services and the federal proxy rules, Staff Legal Bulletin ("SLB") 20 (issued in June 2014) paraphrased the SEC's 1979 release, but omitted the critical "unsolicited" qualifier, thereby erroneously suggesting that all proxy advice is a solicitation.[11]

ISS submits that a registered investment adviser who is contractually obligated to furnish vote recommendations based on client-selected guidelines is not providing "unsolicited" proxy voting advice, and thus is not engaged in a "solicitation" subject to the Exchange Act proxy rules.

ISS does not choose the ballots or agenda items on which we render advice. Rather, at a client's direction, we are asked by our clients to analyze and provide a voting recommendation for each agenda item related to every equity security held in our clients' portfolios. Furthermore, as a disinterested fiduciary, ISS has no financial stake in the outcome of a particular vote. We are agnostic as to whether clients support a proposal, reject the proposal or abstain from voting altogether. We are similarly indifferent to whether clients choose to follow an ISS vote recommendation or not. ISS' only job is to analyze proxy statements

---

[7] Rule 14a-1(1)(iii)

[8] Rule 14a-1(l)(2)(i).

[9] *Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally,* SEC Release No. 34-16104 (August 13, 1979), 44 Fed. Reg. 48938 (August 20, 1979) at note 25.

[10] *Broker-Dealer Participation in Proxy Solicitations,* SEC Release No. 34-7208 (January 7, 1964). This view was restated in a letter from Abigail Arms, Chief Counsel of the Division of Corporation Finance to Richard G. Ketchum, EVP, Legal, Regulatory & Market Policy of the NASD, Inc. dated May 19, 1992.

[11] SLB 20, Question 6.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

and provide informed research and vote recommendations based on the policies and guidelines the institutional investors have selected, and in many cases developed, themselves. Given the diversity of these policies and guidelines and as already noted above, ISS may issue different recommendations on a given issue, for example, recommending voting "AGAINST" on a particular item to clients using ISS' faith-based policy guidelines, and "FOR" on that same issue to clients using ISS' "benchmark" voting policy guidelines.

ISS' fiduciary proxy research and voting advice is simply not the kind of "over-the-transom" communication that the federal proxy rules are designed to address.

Wholly apart from the question of whether the provision of proxy advice can be considered a solicitation, SLB 20 explains that Exchange Act Rule 14a-2(b)(3) exempts a proxy solicitor who renders voting advice from the information and filing provisions of the proxy rules if the solicitor:

a. furnishes proxy voting advice in the ordinary course of business;

b. discloses to the recipient of the advice any significant relationship with the issuer or any of its affiliates, or a security holder proponent of the matter under advisement, and discloses any material interests the solicitor has in such matter;

c. receives no compensation for furnishing the advice from anyone other than recipients of the advice; and

d. does not furnish the voting advice on behalf of any person soliciting proxies or on behalf of a participant in a contested election.[12]

Although ISS is confident that it is not a proxy solicitor within the meaning of Rule 14a-1(l), we have nonetheless taken steps to ensure that our proxy advisory activities would qualify for the Rule 14a-2(b)(3) exemption if such an exemption were needed. In this regard, after the publication of SLB 20, ISS enhanced our already robust suite of conflict management and disclosure policies by adopting a *Policy Regarding Disclosure of Significant Relationships*. This Policy, which is available in the Due Diligence section of our website,[13] provides a clear explanation of how ISS assesses and discloses any significant relationships that may exist between the company and the subjects of its proxy research reports.

ISS also enhanced its client facing delivery platform, ProxyExchange, to deliver the required disclosures to clients in a way that both seamlessly integrates with their workflows and protects the critical firewall between ISS and its corporate solutions subsidiary.

Question 2 - Report Accuracy

> ➢ *"Currently there are no standards or regulations that apply to these reports prepared by proxy advisory firms... [T]here are often questions about the dependability, accuracy of factual material, and correct assumptions made for each company evaluated."*

[12] SLB 20, Question 9. Questions 10 through 13 address how a proxy advisory firm that acts as a proxy solicitor could make the facts-and-circumstances determination of whether it had a significant relationship with an issuer or security holder proponent or a material interest in the matter under advisement, and how it should make any necessary disclosures related thereto.

[13] htpps://www.issgovernance.com/file/duediligence/significant-relationships-disclosure.pdf. The ISS website contains a range of disclosures that satisfy ISS' regulatory requirements under the Advisers Act and assist fiduciaries who use ISS' services to satisfy their own business and regulatory obligations.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

The first sentence quoted above is inaccurate. In 2010, the SEC confirmed that proxy advice is a form of investment advice subject to the Advisers Act and the rules and regulations thereunder. [14] Among other things, this means that

> as a fiduciary, the proxy advisory firm has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information.[15]

The SEC restated this view just last month in a proposed interpretive release on investment adviser standards of conduct. In addition to confirming that the obligation to provide advice that is in the best interest of clients applies not only to advice regarding potential investments, but to all advice provided to clients, the SEC also confirmed that an adviser has a duty to conduct a reasonable investigation "sufficient to not base its advice on materially inaccurate or incomplete information."[16]

As an RIA and a fiduciary, ISS has adopted a number of policies and procedures designed to ensure the integrity of our data collection and research process, upon which our reports are founded. We have robust systems and controls designed to ensure that research reports and vote recommendations include high-quality, relevant information, are accurate, correctly based on the relevant ISS or client custom policy and are reviewed by appropriate personnel prior to publication. ISS also commissions regular SSAE 16 audits, conducted by a third-party auditor to ensure compliance with our internal control processes, including our research process.

ISS is committed to having the most complete and accurate information upon which to base our research and recommendations to our clients. As described in more detail below, ISS' approach is to use and rely only upon publicly available information in the preparation of our proxy research reports and vote recommendations, the primary source of which is the public filings of the companies that we cover. Within the parameters of that approach, ISS regularly undertakes dialogue and interacts with company representatives, institutional shareholders, shareholder proponents and other relevant stakeholders, both during and outside of "proxy season" to (1) gain the greatest possible insight for our clients and (2) maintain the overall quality of the research by ensuring full information and deeper insight into key issues. ISS' dialogue with issuers is transparent and disclosed to clients.

With respect to factual errors, ISS' research team does, infrequently, identify or receive notice of material factual errors in research reports that have already been published to our clients. These errors include those relating to agenda changes, material data or research/policy application. ISS tracks such occurrences, which are rare. For example, in 2017, ISS covered over 6,400 meetings in the United States and the error rate was approximately 0.76% as measured by post-publication "Proxy Alerts" to clients notifying them of a material error within our benchmark proxy research that resulted in a change of a vote recommendation.

We reiterate the findings of the 2007 GAO Report which concluded that our clients trust us to provide "reliable, efficient services."[17] The GAO's follow-up report in 2016 addressed this further, stating "Both corporate issuers and institutional investors [the GAO] interviewed said that the data errors they found in the proxy reports were mostly minor..."[18]

[14] Concept Release on the U.S. Proxy System, IA Release No. 3052 (July 14, 2010) ("Proxy Concept Release") at 110.

[15] *Id.*, at 119.

[16] Proposed SEC Interpretation Regarding Standard of Conduct for Investment Advisers, IA Release No. 4889 (April 18, 2018) ("IA Interpretive Release"), at 13, *quoting* the Proxy Concept Release.

[17] 2007 GAO Report *supra*, note 1 at 13.

[18] Clements, M. (2016). *Proxy Advisory Firms' Role in Voting and Corporate Governance Practices.* (GAO-17-47). Washington, DC: Government Accountability Office at 29.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

However, we want to underscore that there is a fundamental and important difference between factual errors and disagreements over interpretive judgment and methodology. Although the latter are often referred to as "errors," they do not entail any mistake, omission or misrepresentation. What is often portrayed as an "error" by the management and/or the board of a company may be a disagreement about the vote recommendation itself or about the underlying corporate governance guidelines applied.[19] For example, ISS was recently accused by a company of selecting inappropriate company peers for the purpose of manipulating the assessment of the issuer's executive compensation program in the context of a "say-on-pay" agenda item. However, ISS had, as always, followed its consistent and publicly-disclosed methodology for ISS peer group determinations and had also, in fact, already considered new information provided by the issuer and adjusted our initial determination to remove one peer and add a different one in line with the company's representations. In presenting the information to our clients in our report and consistent with our normal approach, we outlined in side-by-side fashion the peers selected by the issuer and the ISS-selected peers. In this particular case, there was overlap of 12 of the 16 peer companies and the variance was not an error but rather reflected ISS' thoughtful and independent assessment of the matter, precisely what our clients expect of us.

We acknowledge that policy differences on important issues such as executive compensation, overboarding (i.e. how many boards an individual can serve on effectively), and whether the CEO and Chairman of the Board should be different individuals, can sometimes generate tension between shareholders (and by extension ISS) and the companies in which they invest. However, it is the policies selected by our clients that dictate our vote recommendations and the application of those policies does not equate to our work product being erroneous or manipulative.

➢ *"We understand that your company and other proxy advisory firms hire more staff to meet the demands of proxy season by hiring temporary workers and outsourcing a significant amount of research and analytical work."*

To help meet our clients' needs during proxy season, ISS does indeed hire "temporary" employees. Temporary employees are subject to the same employment onboarding procedures that apply to "permanent" hires, including training regarding ISS' compliance program and subject matter training with respect to the tasks and issues that will fall within an employee's work responsibilities. Temporary employees do not undertake work beyond their training and experience and these employees are generally focused on data collection and capture. It is also not uncommon for some "temporary" employees to return to ISS on a recurring basis.

ISS does not outsource any of its research and analytical work.

➢ *"Why hasn't ISS expanded [its] draft review process to include more companies, in order to improve the quality of the reports for issuers not listed in the S&P 500 index? Are you willing to expand the draft review process to companies listed in the S&P 1500, [sic] with a reasonable transition period?"*

As you note, the shareholder proxy season is "short." The condensed schedule affects the process that advisors like ISS employ in producing proxy reports and formulating vote recommendations. ISS has incorporated a limited issuer review step for S&P 500 companies because these companies are the most widely held by our clients and generally have the most complex disclosures. ISS voluntarily provides most companies in this index the opportunity to review the factual accuracy of the data included in ISS' pending proxy analyses. Because we are committed to the accuracy and quality of our reports, we consider other requests for review on a case-by-case basis.

However, given the limited time between the hard start of receiving the proxy statement and the hard stop of delivering the report to our clients with sufficient review time in advance of their having to make their voting decisions, expanding the included coverage universe would require a significant increase in resources and a concurrent increase to our clients of the costs of our services (which, of course, is ultimately borne by the underlying beneficial shareowners). Moreover, even if

[19] As Anne Sheehan of CalSTERS observed at the SEC's Proxy Adviser Roundtable, "What I have found [is] that many times the errors are really differences of opinion." Roundtable Transcript, *supra*, note 2, at 155.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

additional resources were added, the time constraints remain substantial -- we remain concerned about the value and feasibility of accommodating an expanded draft review process and still being able to meet the imperative of providing our clients with our research on a timely basis. ISS does, however, work continually to enhance the quality of all of our product/service offerings, and is open to appropriate changes that are sensible, commercially viable and which would provide additional value to our clients and other stakeholders. Expansion of the coverage universe of our current draft review process is one potential change that ISS has considered and will continue to do so.

All issuers, even if they do not receive a draft report for review, are entitled to receive a free copy of ISS' published analysis for their own shareholder meeting. This affords all issuers the opportunity to bring any factual error in the report to ISS' attention and as noted elsewhere in this response, we have a formal process to update previously issued reports where necessary and communicate those updates to our clients.

➢ *"Do you have specific policies and procedures regarding providing draft report to issuers? If so, please include a copy of those policies and procedures."*

Yes. ISS' approach to the provision of draft reports to issuers (which is available on our website), is as follows:

> There is no entitlement to review our research reports prior to publication to our clients, but draft reports are provided in certain markets as a courtesy and at the sole discretion of ISS, in order to allow an issuer to check the factual information prior to publication. For example, in the United States, companies in the S&P 500 index will generally receive a draft report for fact-checking if they have provided contact details, and for France, the process is set out in our Engagement and Draft Report Disclosure Policy for the French Market.
>
> To ensure consideration can be given to any review responses within the often tight publication deadlines for our reports, any comments should be sent back to ISS by e-mail, although companies are welcome to provide a hard copy as well. Note that this is not an opportunity for the issuer to lobby for a particular voting recommendation, but to check the facts that are being included in our report. Procedures for providing draft reports to companies vary on a market-by-market basis, and in any case, no drafts will be provided in markets or situations where there is insufficient time to do so whilst still respecting our clients' voting deadlines.
>
> For all markets, ISS does not normally allow pre-publication reviews of any analysis relating to any special meeting or any meeting where the agenda includes a merger or acquisition proposal, proxy fight, or any item that ISS, in its sole discretion, considers to be of a contentious or controversial nature. This policy is intended to safeguard the independence of our process and recommendations.

➢ *"When do you provide issuers draft reports and how much times do they have to provide their comments on factual issues?"*

Draft reports are generally emailed to company contacts in the two-to-four week period before an issuer's annual meeting. During the height of proxy season, the time frame may be closer to two to three weeks before the meeting. We will generally advise the company contacts beforehand when to expect the draft report for review, and the cover letter accompanying the draft report specifies the deadline for the issuer's comments, which typically provides the company with 2 business days to provide comments.

➢ *"If an issuer identifies an error in a draft report what corrective measure do you take?"*

If an issuer identifies an error in a draft report, the matter is reviewed by the relevant research analysts and any identified and agreed errors are corrected prior to the finalization of the report and its delivery to our clients.

With respect to final reports that have already been published, if a material error is identified (whether by ISS, the issuer or an investor), or updated relevant information is publicly released by the issuer (for example, through supplemental proxy

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

material filed with the SEC), ISS promptly issues an aforementioned "Proxy Alert" to inform clients of any corrections, new information available and, if necessary, any changes in the vote recommendations as result of those corrections or updates. Alerts are distributed to ISS' clients through the same ProxyExchange platform used to distribute the regular proxy analyses. This ensures that the clients who received an original analysis and recommendations will also receive the related Alert.

➢ *"Do you publicly disclose your guidelines and methodologies for preparing draft reports? If not, why not?"*

Yes. All proprietary proxy analysis at ISS is undertaken in accordance with the publicly disclosed analytical framework which is comprised of the full voting policy guidelines for all policies offered by ISS. The only exception to this is for the client-specific customized policies which are each client's own proprietary information. As described above, ISS offers a wide range of proxy voting policy options, providing to our clients both a benchmark policy focused on good governance principles, shareholder protection and mitigation of governance risk, and a wide array of specialty policies that evaluate governance and other voting issues from the perspective of sustainability, socially responsible investing, public pension funds, labor unions or mission and faith-based investing. To ensure the ISS proprietary voting policies take into consideration the changing views and needs of its institutional investor clients and the perspectives of companies and the broader corporate governance community, ISS gathers input each year from institutional investors, companies, and other market constituents worldwide through a variety of channels and over many months.

Case-by-case analytical frameworks, which take into account company size, financial performance and industry practices, also drive many of ISS' vote recommendations on more complex issues, such as those pertaining to the election of corporate directors, compensation matters, and capital or shareholder rights-related proposals.

All ISS Policy Guidelines for 2018, covering the U.S., all global markets and ISS' specialty policies can be found in the "Policy Gateway" section of our website (https://www.issgovernance.com/policy-gateway/voting-policies/).

Question 3 - Conflicts of Interest

An obligation to either eliminate, or manage and disclose, conflicts of interest is the very essence of an investment adviser's fiduciary duty of loyalty. The SEC most recently confirmed this fact in its proposed interpretive release on investment adviser standards of conduct, saying:

> In seeking to meet its duty of loyalty, an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship. In addition, an adviser must seek to avoid conflicts of interest with its clients, and at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship. The disclosure should be sufficiently specific so that a client is able to decide whether to provide informed consent to the conflict of interest . . . . Because an adviser must serve the best interests of its clients, it has an obligation not to subordinate its clients' interests to its own . . . Accordingly, the duty of loyalty includes a duty not to treat some clients favorably at the expense of other clients.[20]

Advisers Act Rule 206(4)-6 applies this traditional fiduciary concept to proxy voting by requiring an RIA who has expressly or implicitly assumed voting authority over its clients' portfolios to adopt written policies and procedures reasonably designed to ensure that the adviser monitors corporate actions and votes proxies in the clients' best interests; supplies those policies and procedures to clients upon request; and offers clients information about specific votes cast on their behalf.

As an RIA, ISS takes this fiduciary duty of loyalty very seriously. ISS places primary importance on conducting our business in a transparent and responsible manner, and has developed a comprehensive program to manage potential conflicts of interest as required by the Advisers Act and related SEC rules. In this regard, ISS has undertaken a comprehensive risk assessment to identify specific conflicts of interest related to its operations and has adopted

[20] IA Interpretive Release,, *supra* note 15, at 15-16 (citations omitted).

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

compliance controls reasonably designed to manage those risks. Moreover and as discussed above, ISS has adopted a significant relationship disclosure policy and took robust steps to enhance transparency following the promulgation of SLB 20. At the heart of ISS' regulatory compliance program is a deliberate, carefully crafted, regularly tested and periodically updated series of measures designed to eliminate, or manage and disclose conflicts of interest.

Separate and apart from our compliance protocols, ISS addresses conflicts, in part, by being a transparent, policy-based organization, with research and voting recommendations based on publicly-disclosed information available to all shareholders. We provide our clients with an extensive array of information to ensure that they are fully informed of our policies to manage conflicts of interests, and of any potential conflicts and the steps ISS has taken to address them. Among other things, ISS supplies a comprehensive due diligence compliance package, also publicly available on our website, so that our clients can confidently and fully assess the reliability and objectivity of our voting recommendations.

➢ *"Your company has established a consulting service that charges public companies a fee to learn how to best to comply with ISS benchmark voting policies and obtain favorable recommendations in the future."*

To be clear, ISS Corporate Solutions, Inc. ("ICS"), a wholly-owned subsidiary of ISS, provides governance data, analytics and services to corporate issuer clients. ICS' stated mission is help companies design and manage their corporate governance and executive compensation programs to align with company goals, reduce risk, and manage the needs of a diverse shareholder base by delivering best-in-class data, tools, and advisory services. ICS does not and cannot provide any client with any assurance as to how ISS will recommend with respect to the matters that appear on any client's proxy statement.

➢ *"What types of conflicts do you disclose and how accessible are these disclosure[s] to your clients when voting decisions are being made?"*

As required by the Advisers Act's compliance program rule,[21] ISS has implemented, maintains and periodically updates a program designed to eliminate, or manage and disclose, conflicts of interest. In addition to appointing a chief compliance officer, establishing comprehensive compliance policies and procedures, and testing the adequacy of those policies and procedures and the effectiveness of their implementation on an ongoing basis, ISS has also adopted a comprehensive Code of Ethics as the Advisers Act regulatory regime also requires.[22] ISS' Regulatory Code of Ethics is available on our public website at https://www.issgovernance.com/file/duediligence/iss-regulatory-code-and-exhibits-june-2017.pdf. In addition to mandating disclosure regarding an RIA's Code of Ethics, the Advisers Act and related rules also dictate that we provide clients with transparency about our internal operations, including how potential conflicts of interest are addressed.

In conformance with our regulatory obligations, ISS has identified the following potential conflicts:

- Conflicts between ISS' institutional global research department and ICS
- Conflicts within the institutional advisory business
- Conflicts arising from an analyst's stock ownership
- Conflicts in connection with issuers' review of draft analyses
- Conflicts in connection with ISS' ownership structure

Conflict disclosure is addressed first and foremost in the Form ADV disclosure brochure that we must deliver to all clients at the outset of the relationship and must update periodically thereafter.[23] In addition to delivering this brochure to clients, ISS also includes the most recent version of the brochure in the due diligence compliance package available to the public

[21] *See* Advisers Act Rule 206(4)-7.

[22] *See*. Advisers Act Rule 204A-1.

[23] *See*. Advisers Act Rule 204-3.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

on the ISS website. ISS clients can also readily identify any potential conflict of interest through ISS' primary client delivery platform, ProxyExchange, which provides information about the identity of ICS clients, as well as the types of services provided to those issuers and the revenue received from them. Similarly, each proxy analysis and research report issued by ISS contains a legend indicating that the subject of the analysis or report may be a client of ICS. This legend also advises institutional clients about the way in which they can receive additional, specific details about any issuer's use of products and services from ICS, which can be as simple as emailing our Legal/Compliance department.

➢ *"Are you willing to disclose potential and actual conflicts on the front page of company reports, as Glass Lewis does?"*

Although in our experience investment advisers typically disclose conflict-of-interest information at a macro level, ISS does more. Any institutional client that wishes to learn more about the relationship, if any, between ICS and the subject of a particular analysis or report may access this information through ProxyExchange and/or through contacting ISS' Legal/Compliance department for relevant details. This process allows ISS' proxy voting clients to receive the names of ICS clients without revealing that information to research analysts as they prepare vote recommendations and other research. Identifying an ICS relationship on the face of a proxy analysis or report would destroy the conflict-of-interest firewalls we have created in this area. While it would actually be easier for us to provide this disclosure on the report itself, we believe that eliminating such a critical conflict control would not be in our clients' best interest.

➢ *"Do your disclosures include, in monetary terms, the size of the client relationship involved and do you disclose conflicts involv[ing] more than one proponent or active supporter of a particular shareholder proposal?"*

Yes, ISS makes available to its institutional clients the identity of all ICS clients, the particular products/services they receive, and the fees paid to ICS. Again, this information can be readily accessed via the ProxyExchange platform or by emailing ISS' Legal/Compliance department. In addition to obtaining report-by-report conflict information, ISS clients can obtain lists of all ICS clients. Further, many clients meet with ISS staff on an annual basis to discuss conflicts and other due diligence matters.

Beyond the disclosure approach regarding the ICS clients, the *Policy Regarding Disclosure of Significant Relationships* referred to above explains ISS' approach for disclosing other types of potential conflicts, including those that might arise with respect to a proponent or active supporter of a particular shareholder resolution.

➢ *"Does ISS allow hedge fund clients to purchase Special Situations Research or other services at the same time that ISS is recommending for or against a pending merger, buyout, or proxy fight in which the hedge fund has an interest?"*

Yes.

➢ *"Please provide a record of each instance of proxy voting advice that your company or any regulatory body has determined constituted or may have constituted a conflict of interest over the last 10 years, and all related documents and communication. If no such record is maintained, please explain why."*

ISS is not aware of any instance in which a proxy research report or a vote recommendation was compromised by a conflict of interest, nor any instance where a regulatory body has reached that conclusion. As discussed at length above, ISS has worked hard to identify potential conflicts of interest and taken concrete steps to manage and mitigate those potential conflicts so that they do not impact the efficacy or integrity of our research and recommendations. We are heartened by the fact that the most vocal critics of ISS on this point are those who speak on behalf of corporate management, and not the investors who rely on ISS' research and vote recommendations. We see this as a strong indication that we are managing this potential conflict extremely well.

➢ *"Please provide a list of all outside entities from whom you obtain information referring or relating to your proxy voting advice, and descriptions of any evaluations that are performed to ensure such information is accurate and that*

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

the information provider does not have a conflict of interest with the company with respect to which the information is being provided."

As explained above, ISS' approach is to use and rely only upon publicly available information in the preparation of our proxy research reports and vote recommendations. The primary source of that information is the public filings of the companies that we cover, meaning, for U.S. companies, the proxy statement and other reporting materials that companies are required to file with the SEC, supplemented by press releases, information from a company's website and other generally accessible information. ISS also uses a small number of third-party vendors to provide standardized financial information and securities identifiers. ISS submits that this approach fully complies with our fiduciary duty of care described above.

- *"We are interested in whether you disclose two other types of conflict of interest. The first of these two conflicts involves cross-ownership, where owners or executives of your firm may have a significant ownership interest in, or serve on the board of directors of entities that have proposals on which the firm is offering vote recommendations. The second conflict involves other financial interests by your owner, Genstar Capital."*
- *"Are you disclosing these financial or business relationships when they involve or include a proponent or an active supporter of matters in which you are making voting recommendations?"*

ISS' executives, like all of our employees, are required to disclose to ISS and ISS will, in turn, disclose to our clients any significant (or material) ownership interest that an executive might have with regard to a company on which we are providing proxy research coverage.[24] ISS' executives are not permitted to sit on the Board of Directors of a public company except in extremely limited circumstances and only with the approval of ISS' General Counsel and the company's senior management. No such exceptions are currently in effect and so no ISS employee currently serves as a director of a public company.

ISS is a privately-held company, whose ultimate owner is affiliated with Genstar Capital, a private equity firm. ISS has adopted a Policy on Potential Conflicts of Interest Related to Genstar Capital and its affiliated funds (the "Genstar Policy"). Among other things, the Genstar Policy provides that Genstar persons (defined as Genstar directors and certain others) may not participate in the formulation, development and application of ISS voting policies, and will not have access to any data relating to the portfolio, investment strategy or securities holdings of ISS clients. In addition, as a private equity firm that owns or controls a number of operating companies, some of which may become publicly traded, and may thereafter be the subject to ISS research, we recognize that actual or potential conflicts of interest, or the appearance of conflicts, could arise in the production by ISS of research with respect to coverage of such a Genstar company (what we refer to as a "Genstar Affiliated Company"). ISS therefore provides disclosure of these relationships on its website, and includes information about any such relationship in the research report for any issuer that happens to be a Genstar Affiliated Company. Currently, there are no Genstar Affiliated Companies.

Pertinent Legislation before the Senate Banking Committee

Finally, we want to reiterate our strong view that both of the pertinent legislative proposals before the Senate Banking Committee – H.R. 4015, "The Corporate Governance Reform and Transparency Act," and Subtitle Q of Title IV under H.R.10, "The Financial CHOICE Act" (FCA) – are misguided attempts to improve corporate governance. Each of these proposals would only deepen your concerns about industry competition and conflicts of interest. Each proposal would eliminate a proxy adviser's existing fiduciary duties of care and loyalty to investors, the owners of the companies in which they invest, and would infuse a proxy adviser's operations with a new issuer-related conflict of interest that would be

[24] Note that the ISS Regulatory Code of Ethics requires all employees to provide the ISS compliance department with account statements for all securities investment accounts for the employees and members of their immediate families. Certain types of trades must be pre-cleared and ISS imposes black-out periods on trading of issuers whose proxies are currently being analyzed or acted upon by the company. This black-out period extends from the time ISS logs receipt of the subject proxy into the Global Research database of meetings, until one day after the shareholders' meeting being covered.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

difficult to manage effectively. In this way, either bill, if enacted, would harm every shareholder who relies on independent research to make informed investment decisions.

Shareholders should have the right to choose the tools, services and information they need to make informed proxy voting decisions– without it being filtered through the management of the corporation in question. This is a fundamental tenet of corporate governance and it is why this bill is opposed by a number of large public sector pension fund managers, as well as many other institutional investors, including the CII, NCPERS, AFL-CIO, AFSCME and Teamsters to name a few.

The proposed new regulatory regime under both bills will do nothing to enhance competition in the industry. Indeed, it may actually erect barriers to entry and make it more difficult for smaller industry participants to compete. The proposed regulatory regime is unnecessary, burdensome and would do nothing to enhance market competition or create market conditions conducive to new proxy advisors entering the market. CII wrote in its most recent opposition letter that the proposed regulatory regime would "**increase barriers** [emphasis supplied] to new entrants and potentially lead some current proxy advisory firms to exit the industry altogether."[25]

The National Conference on Public Employee Retirement Systems (NCPERS), the largest national, nonprofit public pension advocate whose members manage more than $3 trillion in pension assets, warned that the suggested regime proposes to "bypass free-market principles by authorizing the SEC to pre-qualify industry entrants based on a set of vague and highly subjective standards."[26] Such authority would likely provide the SEC – under this and future Administrations – with broad discretion to establish criteria to further restrict, not enhance, competition.

The litmus test for any federal intrusion into the free market is whether it targets a proven problem and seeks to address it cost-effectively. The proposed bill does not pass either test. As the foregoing discussion demonstrates, the investors who use proxy advisory services do not see the "problem" the proposed legislation purports to address. Furthermore, the bill's backers fail to provide any cost-benefit analysis to support the idea of supplanting a comprehensive and mature regulatory regime with a brand new scheme that will require several years of new SEC rulemaking only to end up with something that favors entrenched corporate interests over shareholders, freedom of choice, freedom of expression and free-market capitalism.

In conclusion, ISS appreciates the opportunity to answer your questions and underscore the rigorous regulatory system and internal compliance program under which we operate. If there is any additional information I can provide, please do not hesitate to contact me.

Sincerely,

Gary Retelny, President and CEO
Institutional Shareholder Services Inc.

[25] Letter from the CII to Sen. Michael Crapo, Chair of the Senate Committee on Banking, Housing and Urban Affairs and Sen. Sherrod Brown, Ranking Member of the Senate Committee on Banking, Housing and Urban Affairs (February 28, 2018) at 2.

[26] Letter from NCPERS to Sen. Michael Crapo, Chair of the Senate Committee on Banking, Housing and Urban Affairs and Sen. Sherrod Brown, Ranking Member of the Senate Committee on Banking, Housing and Urban Affairs (February 16, 2018) at 2.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

Filed Electronically

November 7, 2018

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: SEC Staff Roundtable on the Proxy Process, File Number 4-725

Dear Mr. Fields:

Institutional Shareholder Services Inc. (ISS), an investment adviser registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940 (Advisers Act), is a full-service proxy adviser. We have more than 30 years of experience helping institutional investors to make informed proxy voting decisions, to manage the complex process of voting their shares, and to report their votes to their stakeholders and regulators. ISS annually covers more than 39,000 shareholder meetings -- every holding in ISS' clients' portfolios -- in the United States as well as in over 100 developed and emerging markets worldwide.

As part of our core offerings, ISS enables our clients to receive customized proxy voting recommendations based on a client's specific customized voting guidelines. ISS implements more than 400 custom voting policies on behalf of institutional investor clients. As of January 1, 2018, approximately 85% of ISS' top 100 clients used a custom proxy voting policy. During calendar year 2017, approximately 87% of the total shares processed by ISS on behalf of clients globally were linked to such policies.

ISS also offers a wide range of proxy voting policy options, including our publicly available standard benchmark policies focused on promoting long-term shareholder value creation and risk mitigation at portfolio firms, and specialty policies, also publicly available, that evaluate governance issues from the perspective of sustainability, socially-responsible investing, public funds, labor unions or mission and faith-based investing. Case-by-case analytical frameworks, which take into account company size, financial performance and industry practices, drive the vast majority of ISS' vote recommendations to our clients. We refer you to our website for detailed information about our voting policy guidelines.[1]

Given our role in the proxy ecosystem, ISS appreciates the opportunity to comment in advance of the Staff Roundtable on the Proxy Process that is scheduled for November 15, 2018. We focus these preliminary comments on two primary areas, proxy advisory firms and the proxy process.

[1] https://www.issgovernance.com/policy-gateway/voting-policies/

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

A. Proxy Advisory Firms

As a registered investment adviser, we have a fiduciary obligation to our clients to provide advice that is in their best interest. In the free market, our clients hire us because we provide services they value and deem to be cost-effective. We listen to our clients and make our vote recommendations based on the governance policies they have selected – whether benchmark or customized. Unfortunately, many of our critics confuse causation and correlation on these vote recommendations, inferring that our clients blindly follow our advice. In fact, our clients are sophisticated institutional investors who are free to follow our recommendations or not. Often, the information that we provide to our clients is one of many different inputs they use to make their voting decisions. They often vote in accordance with our recommendations because those recommendations are tailored to their own views on corporate governance, not because they follow our advice without thought or intention.

As illustrated by the 2013 Staff Proxy Advisory Firms Roundtable,(2013 Roundtable)[2] and confirmed repeatedly during the five years since, proxy advisers have become a surrogate for shareholders themselves in the debate regarding what kind of voice investors should have in the companies they own. ISS looks forward to a robust and balanced discussion of the role and regulation of proxy advisory firms at the upcoming Proxy Process Roundtable. To set the stage for this conversation, we would like to briefly address the areas of interest that Chairman Clayton identified in his statement announcing the Roundtable.[3]

1. Whether the Regulatory Environment Has Caused Investment Advisers to Over-Rely on Proxy Advisory Firms, and Whether the Use of Such Firms is in the Best Interest of Investment Advisers' Clients

One of the most persistent urban legends about proxy advisory firms is that the SEC created the market for independent proxy advice by obligating investment advisers and mutual funds to vote every proxy that comes their way, and by creating a "safe harbor" that lets investment advisers outsource their fiduciary duties to proxy advisers. Nothing could be further from the truth.

As Chairman Clayton noted in announcing the upcoming Roundtable, the proxy process is a fundamental component of shareholder engagement, which is a hallmark of our public capital markets. Because proxy voting affects shareholder value and, in special situations, may involve the purchase or sale of securities, the standards of conduct that apply to this activity derive from the standards that apply to rendering investment advice generally.

---

[2] *See* Transcript of Proxy Advisory Firms Roundtable (December 5, 2013), available at www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt

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

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

The U.S. Department of Labor (DOL) first articulated the fiduciary implications of proxy voting thirty years ago. In a letter to the Chairman of the Retirement Board of Avon Products about proxy voting for employee benefits plans subject to ERISA, the DOL said:

> *In general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock.*[4]

In the wake of Enron's widely publicized failure of corporate governance, the SEC likewise recognized the fiduciary implications of proxy voting, when then-SEC Chairman Harvey Pitt gave the following guidance concerning investment advisers' duty to vote proxies on their clients' behalf:

> *We believe . . . that an investment adviser must exercise its responsibility to vote the shares of its clients in a manner that is consistent with the general antifraud provisions of the Advisers Act, as well as its fiduciary duties under federal and state law to act in the best interests of its clients.*[5]

The Commission formalized this view in 2003, when it adopted new rules and rule amendments relating to proxy voting by registered investment advisers and registered investment companies. In adopting Advisers Act Rule 206(4)-6, the SEC said:

> *The federal securities laws do not specifically address how an adviser must exercise its proxy voting authority for its clients. Under the Advisers Act, however, an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting. The duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies. To satisfy its duty of loyalty, the adviser must cast the proxy votes in a manner consistent with the best interest of its client and must not subrogate client interests to its own.*[6]

Rule 206(4)-6 applies these traditional fiduciary concepts by requiring registered investment advisers to adopt written policies and procedures reasonably designed to ensure that the adviser monitors corporate actions and votes client proxies in the clients' best interests. What the rule does *not* do is require investment advisers to vote *every* proxy, regardless of facts and circumstances. To begin with, the rule applies only to those advisers who have explicitly or implicitly assumed voting authority over their clients' portfolios. Many small advisers expressly disclaim such authority and do not offer a proxy voting service to their clients. Even where an

[4] Letter from Alan D. Lebowitz, Deputy Assistant Secretary to Mr. Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. (February 23, 1988), 1988 ERISA LEXIS 19, *5-6 (Avon Letter).

[5] Letter from Harvey Pitt, SEC Chairman to John M. Higgins, President, Ram Trust Services (February 12, 2002). *See also* Baue, Walter, "SEC Chair Calls Proxy Voting a Fiduciary Duty" (March 29, 2002) available at: www.socialfunds.com/news/article.cgi/808.html.

[6] *Proxy Voting by Investment Advisers*, Advisers Act Rel. No. 2106 (January 31, 2003), 68 Fed. Reg. 6585, 6586 (February 7, 2003) (Proxy Rule Release) (citations omitted).

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

adviser undertakes to provide this service, the obligation to vote any particular proxy depends on facts and circumstances. In the Commission's words:

> *We do not suggest that an adviser that fails to vote every proxy would necessarily violate its fiduciary obligations. There may even be times when refraining from voting a proxy is in the client's best interest, such as when the adviser determines that the cost of voting the proxy exceeds the expected benefit to the client. An adviser may not, however, ignore or be negligent in fulfilling the obligation it has assumed to vote client proxies.*[7]

Likewise, the Commission's rulemaking on proxy voting by mutual funds does not obligate funds to vote every available proxy relating to portfolio securities, but merely requires funds to disclose the policies and procedures they use to determine how to vote proxies and to file annual reports disclosing how their votes were cast.[8] In adopting these modest requirements, the Commission noted an increased assertiveness on the part of mutual funds in exercising proxy voting responsibilities. The Commission attributed this trend to a number of factors, including the size of positions in particular portfolio companies that make it difficult to sell a poorly managed company's stock; the investment policies of index funds that have the same effect; and corporate scandals that created renewed investor interest in issues of corporate governance.[9] In other words, institutions vote proxies to maximize shareholder value and satisfy the demands of those for whom they are managing investments, not to satisfy any regulatory mandate.

Nor has the regulatory environment created a safe harbor for investment advisers who engage proxy advisory firms. The genesis of this myth seems to be a reference to proxy advisers in the adopting release for Rule 206(4)-6. In discussing the ways in which investment advisers could manage potential conflicts of interest that might arise in the proxy voting process, the Commission said:

> *Advisers today use various means of ensuring that proxy votes are voted in their clients' best interests and not affected by the advisers' conflicts of interest. An adviser that votes securities based on a pre-determined voting policy could demonstrate that its vote was not a product of a conflict of interest if the application of the policy to the matter presented to shareholders involved little discretion on the part of the adviser. Similarly, an adviser could demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party. An adviser could also suggest that the client engage another party to determine how the proxies should be voted, which would relieve the adviser of the responsibility to vote the proxies. Other policies*

[7] *Id.*, 68 Fed. Reg. at 6587 (citations omitted).

[8] *See Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies,* Investment Company Act Rel. No. 25922 (January 31, 2003), 68 Fed. Reg. 6564 (February 7, 2003).

[9] *Id.* at 3, 68 Fed. Reg. at 6565.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

> *and procedures are also available; their effectiveness (and the effectiveness of any policies and procedures) will turn on how well they insulate the decision on how to vote client proxies from the conflict.*[10]

The Commission's recognition that advisers can mitigate conflicts of interest in proxy voting by seeking the advice of an independent third party was hardly radical, since the same approach is widely utilized in other areas of investment management, such as portfolio valuation, or the appointment of a sub-adviser to make investment decisions for a discrete part of a managed portfolio. In all these cases, an adviser who engages a third-party service provider retains ultimate fiduciary responsibility for the services performed. The Commission recognized this fact when it said:

> *Nothing in [Rule 206(4)-6] reduces or alters any fiduciary obligation applicable to any investment adviser (or person associated [therewith].*[11]

And that statement echoed the DOL's position in the Avon Letter:

> *ERISA contains no provision which would relieve an investment manager of fiduciary liability for any decision he made at the direction of another person. . . Therefore, to the extent that anyone purports to . . . delegate to another the responsibility for such voting decisions, the manager would not be relieved of its own responsibilities and related liabilities merely because it either follows the direction of some other person, or has delegated the responsibility to some other person.*[12]

ISS provides institutional investors with critical assistance in analyzing and synthesizing an enormous volume of information in a short period of time, thereby giving investors a meaningful voice in corporate governance while maximizing the efficient use of limited manager resources. ISS' institutional clients are keenly aware of their fiduciary duty to act in the best interests of their own clients and beneficiaries, and ISS is keenly aware of its fiduciary duty to act in the best interests of its clients. Given the number and complexity of issues to be voted on (especially for investors with global portfolio holdings), these clients believe that their ability to satisfy their fiduciary obligations would be diminished without access to the proxy advisory services ISS provides. We agree.

On the topic of "Main Street" investors, we think it important to point out that many of these investors participate in the equity markets through retirement or other investment accounts that are managed by institutional investors. In addition, many U.S. households participate in the capital markets by investing in mutual funds.[13] In this way, retail investors are ultimately the beneficiaries of the critical work that ISS does for its institutional clients.

---

[10] Proxy Rule Release, 68 Fed. Reg. at 6588 (citations omitted).

[11] *Id.* at note 8.

[12] Avon Letter, 1988 ERISA LEXIS 19,*7-9.

[13] In a May 2018 speech at Temple University, Chairman Clayton noted that fifty-six million U.S. households (44% of all households) own at least one U.S. mutual fund. Jay Clayton, "The Evolving Market for Retail Investment Services and Forward-Looking Regulation – Adding Clarity and Investor

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

2. Whether Staff Guidance About Investment Advisers' Responsibilities in Voting Client Proxies and Retaining Proxy Advisory Firms Should Be Modified, Rescinded, or Supplemented

A corollary to the myth that the SEC's rules have led to over-reliance on proxy advisory firms is the myth that staff guidance has done so. Over the years, the staff issued three pieces of formal guidance in this area: two interpretive letters (Interpretive Letters) a year after the proxy voting rules were adopted,[14] and a staff legal bulletin (SLB 20), issued in the wake of the 2013 Roundtable.[15] On September 15, 2018, the staff withdrew the Interpretive Letters but left intact SLB 20 – which relies in part on the Interpretive Letters. Although the Interpretive Letters merely described fiduciary duties that continue to exist even in the absence of staff guidance, the Letters' abrupt withdrawal has created confusion among investment advisers by suggesting there was something wrong with the underlying guidance.

ISS respectfully requests that the Commission either direct the staff to issue new guidance in this area, or issue its own interpretive release to eliminate this confusion. In either case, we suggest that the replacement guidance regarding investment advisers' obligations when using third-party proxy advisory firms restate the following principles articulated in the Interpretive Letters and SLB 20:

- Whether an investment adviser breaches or fulfills its fiduciary duty of care when employing a proxy advisory firm depends upon all of the relevant facts and circumstances.

- An investment adviser must take reasonable steps to ensure that the proxy advisory firm is competent to adequately analyze proxy issues and to make recommendations in an impartial manner and in the best interests of the adviser's clients.

- These steps may include a case-by-case evaluation of the proxy voting firm's relationships with issuers, a thorough review of the proxy advisory firm's conflict procedures and the effectiveness of their implementation, and/or other means reasonably designed to ensure the integrity of the proxy voting process.

Protection While Ensuring Access and Choice" (May 2, 2018), *available at* *https://www.sec.gov/news/speech/speech-clayton-2018-05-02.*

[14] Letter from Douglas Scheidt, Associate Director and Chief Counsel, SEC Division of Investment Management to Kent S. Hughes, Egan Jones Proxy Services, 2004 SEC No-Act. LEXIS 636 (May 27, 2004) ; and letter from Douglas Scheidt, to Mari-Anne Pisarri, Pickard and Djinis LLP, Counsel for Institutional Shareholder Services Inc., 2004 SEC No-Act. LEXIS 736 (September 15, 2004).

[15] SEC Division of Investment Management, Division of Corporation Finance, *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms,* Staff Legal Bulletin No. 20 (IM/CF) (June 30, 2014), *available at* http://www.sec.gov/interps/legal/cfslb20.htm.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

- An investment adviser should have a thorough understanding of the proxy voting firm's business and the nature of the conflicts of interest that the business presents, and should assess whether the firm's conflict procedures adequately address any such conflicts.
- Because a proxy advisory firm's business and/or conflict procedures could change over time, the investment adviser has a fiduciary duty to monitor the third-party service provider's independence on an ongoing basis.
- Retention of a third-party proxy advisory firm is a fiduciary act. An investment adviser who undertakes to vote proxies on a client's behalf cannot outsource its fiduciary duty to a third party without client consent.
- In accordance with Advisers Act Rule 206(4)-7, an investment adviser has a duty to at least annually assess the sufficiency of its own proxy voting policies and procedures and the effectiveness of the implementation of those policies and procedures.
- One way an investment adviser can confirm that its clients' proxies are being voted in accordance with clients' best interests and with the adviser's proxy voting procedures, is by periodically sampling votes cast.

These principles are consistent with the principles that apply whenever an investment adviser engages a third-party service provider to assist with its investment management responsibilities.

Any new guidance on proxy voting responsibilities should also confirm that investment advisers have no absolute duty to vote every proxy relating to their clients' portfolios. Instead, advisers and their clients have the flexibility to determine the scope of the adviser's duty to exercise proxy voting authority, which may be limited by time and cost considerations or the type of issue presented.

In addition to addressing investment advisers' responsibilities with regard to voting client proxies and retaining proxy advisory firms, the staff has also issued guidance on the interplay between proxy advisory services and the federal proxy rules under section 14 of the Exchange Act. However, unlike the Advisers Act guidance, which is consistent with historic views on advisers' fiduciary duties, the proxy rule guidance cannot be squared with applicable historic guidance.

Exchange Act Rule 14a-1(l) defines a proxy "solicitation" to include the "furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." The furnishing of a proxy pursuant to a security holder's unsolicited request is excluded from this definition.[16]

[16] 17 C.F.R. §240.14a-1(l)(2)(i).

ISS
Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

Both the SEC and the staff have historically recognized the distinction between unsolicited and solicited proxy advice, applying the Exchange Act proxy rules to the former, but not the latter. For example, in a 1979 release, the SEC explained that, "As a general matter, unsolicited proxy voting advice would constitute a 'solicitation' subject to the proxy rules."[17] In making this observation, the SEC cited an earlier opinion of the SEC's General Counsel that addressed proxy advice in a broker-dealer context:

> In our view a broker normally is not engaged in solicitation where he merely responds, whether orally or in writing, to an unsolicited request from a customer for advice as to how to vote. Since the broker is merely responding to his customer's request for advice in his capacity as adviser to the customer and not actively initiating the communication, it may be concluded that he is not engaged in 'soliciting.'[18]

Unfortunately, SLB 20 blurred the longstanding distinction between solicited and unsolicited proxy voting advice. In paraphrasing the SEC's 1979 release, the staff omitted the critical "unsolicited" qualifier, thereby erroneously suggesting that all proxy advice is a solicitation.[19]

ISS respectfully asks the Commission to correct this omission and to confirm that a registered investment adviser who is contractually obligated to furnish vote recommendations based on client-selected guidelines does not provide "unsolicited" proxy voting advice, and thus is not engaged in a "solicitation" subject to the Exchange Act proxy rules.

ISS does not choose the ballots or agenda items on which it renders advice. Rather, at a client's direction, ISS has a fiduciary duty to analyze and provide a voting recommendation for each agenda item related to every equity security held in clients' portfolios. ISS is agnostic as to whether clients support a proposal, reject the proposal or abstain from voting altogether. ISS is similarly indifferent to whether clients choose to follow an ISS vote recommendation or not. ISS' only job is to analyze proxy statements and provide informed research and vote recommendations based on the policies and guidelines the institutional investors have selected, and in many cases developed, themselves. Given the diversity of these policies and guidelines, ISS may issue different recommendations on a given issue, for example, recommending voting "AGAINST" on a particular item to clients using ISS' faith-based policy guidelines, and "FOR" on that same issue to clients using ISS' "benchmark" voting policy guidelines.

---

[17] *Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally,* Exchange Act Release No. 16104 (August 13, 1979), 44 Fed. Reg. 48938 (August 20, 1979) at note 25.

[18] *Broker-Dealer Participation in Proxy Solicitations,* Exchange Act Release No. 7208 (January 7, 1964), 29 Fed. Reg. (January 15, 1964). This view was restated in a letter from Abigail Arms, Chief Counsel of the Division of Corporation Finance to Richard G. Ketchum, EVP, Legal, Regulatory & Market Policy of the NASD, Inc. dated May 19, 1992.

[19] SLB 20, Question 6.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

ISS' fiduciary proxy research and voting advice is simply not the kind of "over-the-transom" communication that the federal proxy rules are designed to address.

3. The Appropriate Regulatory Regime for Proxy Advisory Firms

In the SEC's 2010 Concept Release on the U.S. Proxy System (2010 Concept Release),[20] the Commission confirmed that proxy advisory firms are "investment advisers" as defined in the Advisers Act, saying:

> *[P]roxy advisory firms receive compensation for providing voting recommendations and analysis on matters submitted for a vote at shareholder meetings. . . . We understand that typically proxy advisory firms represent that they provide their clients with advice designed to enable institutional clients to maximize the value of their investments. In other words, proxy advisory firms provide analyses of shareholder proposals, director candidacies or corporate actions and provide advice concerning particular votes in a manner that is intended to assist their institutional clients in achieving their investment goals with respect to the voting securities they hold. In that way, proxy advisory firms meet the definition of investment adviser because they, for compensation, engage in the business of issuing reports or analyses concerning securities and providing advice to others as to the value of securities.*[21]

ISS agrees. Not only does proxy voting advice clearly relate to the value of securities, but in the case of mergers, acquisitions and tender offers, it also relates to the advisability of purchasing, selling or investing in securities. Furthermore, where a proxy advisory firm assists clients in developing proxy voting policies or where it tailors its proxy voting research, analysis or vote recommendations to policies or guidelines developed or selected by the firm's clients, the proxy advisory firm does not qualify for the "publisher's exception" under Section 202(a)(11)(D) of the Advisers Act.[22]

Furthermore, as a proxy advisory firm that has been registered under the Advisers Act for more than twenty years, ISS believes that subjecting proxy advisers to the same fiduciary standards that apply to the asset managers who use their services provides a critical layer of protection for investors. Having the option to receive proxy analyses and recommendations based on custom voting policies or a variety of ISS policies geared to different investor needs enables investment advisers to tailor their voting practices to each client's best interest. And the extensive array of policies and procedures ISS has adopted to satisfy its fiduciary duties of care and loyalty make it easier for investment managers to satisfy their own fiduciary obligation to conduct comprehensive due diligence before

---

[20] Advisers Act Release No. 3052 at 109-110, 75 Fed. Reg. 42981, 43010 (July 22, 2010).

[21] *Id.* at 109-110, 75 Fed. Reg. at 43010.

[22] This exception is unavailable where the advice in question is "personalized" or attuned to client needs. *Lowe v. SEC*, 472 U.S. 181 (1985).

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

engaging a proxy advisory service. In short, a harmonized fiduciary standard around proxy voting provides end-to-end protection of investors' best interests.

As it stands today, three of the five U.S. proxy advisory firms are registered under the Advisers Act. ISS urges the Commission to take steps to bring all proxy advisory firms under this fiduciary regulatory regime, adding a new "proxy advisory firm" category to the Advisers Act jurisdictional registration rule (Rule 203A-2) if necessary.

4. Whether Issuers Have Appropriate Opportunity to Express Concerns About Proxy Advisers' Vote Recommendations

As a registered investment adviser, ISS has a fiduciary duty of care to make a reasonable investigation to determine that it is not basing vote recommendations on materially inaccurate or incomplete information. In satisfaction of this duty, ISS has adopted a number of policies and procedures designed to ensure the integrity of our research process. To begin with, ISS' analyses and recommendations are driven by publicly disclosed and detailed policy guidelines and public information about the relevant proxy issues, in order to ensure consistency and to eliminate potential analyst implementation bias. In addition, before being delivered to clients, each proxy analysis undergoes a rigorous internal review for factual accuracy and to ensure that the relevant voting policy has been properly applied.[23]

The entire analytical process, beginning with the receipt of the proxy statement, through the end of the internal review of the proxy report and vote recommendations, must be completed sufficiently in advance of the shareholder meeting to give the investor client adequate time to evaluate the report, conduct any additional analysis it deems necessary, engage with the issuer's executives and board members as needed, make a voting decision and process that decision for voting. In many cases, ISS has a contractual obligation to deliver proxy reports and vote recommendations to clients ten days to two weeks in advance of the meeting.

Despite this extremely tight timeframe, ISS has voluntarily incorporated a limited issuer review step into the analytical process. In the U.S., constituents of the Standard and Poor's 500 Index generally receive an opportunity to review a draft analysis for factual accuracy prior to the delivery of the report to clients, and ISS considers other requests for review and comments on a case-by-case basis. Given the limited time between the hard start of receiving the proxy statement and the hard stop of delivering the report to clients sufficiently in advance of the meeting, along with the concentration of a large percentage of meetings during so called "proxy season," there simply is not time to afford all of the approximately 39,000 issuers ISS covers globally the opportunity to review draft reports. However, ISS offers **all** issuers a free copy of the published analysis for their own shareholder meetings upon request. This affords issuers the opportunity to bring any factual error in the report to ISS' attention. In many cases, however, what issuers consider to be "errors" are in fact differences in philosophy, interpretation or, simply, outright disagreements with ISS' voting policies.

23 As noted below, ISS obtains annual SSAE 18 audits to ensure compliance with its internal control processes, including its research process.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

While ISS is proud of its record of accuracy and integrity, and strives to be as accurate as possible, ISS' research team does, infrequently, identify material factual errors in research reports, such as those relating to the agenda, data or research/policy application. When this happens, or when ISS learns of a material factual error from the issuer or an investor, ISS promptly issues a "Proxy Alert" ("Alert") to inform clients of any corrections and, if necessary, any changes in the vote recommendations as result of those corrections or updates. Alerts are distributed to ISS' investor clients through the same ProxyExchange platform used to distribute the regular proxy analyses. This ensures that the clients who received an original analysis will also receive the related Alert, which is attached to the relevant company meeting. Even if a client has cast its vote before receiving an Alert, the client may cancel and change its vote at any time before the meeting date, if such a change is warranted by the new information.

Although we understand that some issuers believe they should have the right to review and object to every vote recommendation ISS makes – and in some cases, even interject their views into ISS proxy research reports – granting issuers such extreme influence over independent proxy advice would interfere with a proxy adviser's fiduciary responsibility to its clients, and hurt both investors and the integrity of the voting process. Issuers already have ample opportunities to communicate with shareholders through the proxy statement, 8-K filings, and proxy solicitor communications.

5. Whether Proxy Advisers' Proxy Voting Guidelines and Procedures Are Sufficiently Transparent.

ISS is proud of the transparency with which it formulates its standard benchmark and specialty proxy voting policies and guidelines. Each year, ISS' policy-setting process begins with a Policy Survey seeking input from both institutional investors, corporate issuers (both executives and board members) and others, such as academics, in an effort to identify emerging issues that merit attention prior to the upcoming proxy season.[24] Based on this feedback, ISS convenes a series of roundtables with various industry groups and outside issue experts to gather multiple perspectives on complex or contentious issues. As part of this process, ISS examines academic literature, other empirical research and relevant commentary in an effort to uncover potential links between an issue and financial returns and/or risk. ISS also back tests any proposed changes to understand the possible impact of the various policy options being considered. Such impact assessments often lead ISS to phase-in new policies over a multi-year period to allow corporate issuers adequate time to prepare for any changes.

[24] In 2018, ISS received survey responses from more than 650 parties, including close to 110 institutions and just over 450 from corporations and their representatives. ISS is in the process right now of eliciting feedback on its 2019 draft benchmark voting policy updates. Consistent with prior years, ISS expects to receive feedback from dozens of parties, including trade groups, such as the Society of Corporate Secretaries and Governance Professionals, the Center on Executive Compensation, the National Association of Corporate Directors, the National Association of Manufacturers, and the U.S. Chamber of Commerce.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

The ISS Global Policy Board, which is comprised of ISS' market research heads and internal subject-matter experts, uses this input to develop its draft policy updates. Before finalizing these updates, ISS publishes them for an open review and comment period (modeled on the SEC's process for commenting on pending rule-making). This open comment period is designed to elicit objective, specific feedback from investors, corporate issuers and industry-constituents on the practical implementation of proposed policies. For the past several years, unless a commenter requests confidential treatment, all comments received by ISS have been posted *verbatim* to the ISS Policy Gateway on its public website, in order to provide additional transparency into the feedback ISS has received. Final updates are published in November to apply to meetings held after February of the following year.

In addition to the Global Policy Board, ISS also has established a Feedback Review Board ("FRB"), which I chair, to provide an additional conduit for investors, executives, directors and other market constituents to communicate with ISS.

ISS' outreach is not confined to the policy-setting process. Robust engagement is an integral part of ISS' day-to-day operations. Each proxy season, ISS engages with thousands of corporate executives, board members, institutional investors and other constituents via in-person meetings, conference calls and participation in industry events. The purpose of such engagement is for ISS to obtain, or communicate, perspectives about governance and voting issues, in order to ensure that its research and policy-driven recommendations are based on the most comprehensive and accurate information available.

6. Whether Proxy Advisers Effectively Mitigate and Disclose Their Conflicts of Interest

As a registered investment adviser, ISS has a duty of loyalty which forbids it from placing its own interests above those of its clients, or to unfairly favor one client over another. While this duty does not prohibit all conflicts outright, it does oblige ISS to manage and fully disclose any conflict it may have.

ISS addresses conflicts, first and foremost, by being a transparent, policy-based organization. Its use of a series of published voting policies provides a very practical check and balance that ensures the integrity and independence of ISS' analyses and vote recommendations. While these policies allow analysts to consider company- and market-specific factors in generating vote recommendations, the existence of a published analytical framework, coupled with the fact that vote recommendations are based on publicly-available information, allows ISS clients to continuously monitor the integrity and consistency of ISS advice.

Furthermore, ISS has undertaken a comprehensive risk assessment to identify specific conflicts of interest related to its operations and has adopted compliance controls reasonably designed to manage each of those risks. In order to ensure the effectiveness of these controls, ISS conducts periodic training sessions for employees and conducts a range of transactional and forensic tests to monitor compliance. We refer you to our public website for information about the policies and procedures we have implemented to help ensure the integrity of our business operations.[25]

[25] https://www.issgovernance.com/compliance/due-diligence-materials/

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

a. Conflicts in Connection with Affiliated Corporate Services

The most talked-about conflict where ISS is concerned relates to the fact that one of its subsidiaries, ISS Corporate Solutions, Inc. ("ICS"), provides governance tools and services to corporate issuer clients. Left unchecked, this conflict could result in vote recommendations that are biased in favor of corporate management. However, the fact that the most vocal critics of ISS are those who speak on behalf of corporate management, and not the investors who rely on ISS' research and vote recommendations, indicates that ISS is managing the potential of this conflict extremely well.

The primary control for this risk is the firewall ISS maintains between the core institutional business and the ICS business. This firewall includes the physical and functional separation between ICS and ISS, with a particular focus on the separation of ICS from the ISS Global Research team. A key goal of the firewall is to keep the ISS Global Research team from learning the identity of ICS' clients, thereby ensuring the objectivity and independence of ISS' research process and vote recommendations. The firewall mitigates potential conflicts via several layers of separation:

- ICS is a separate legal entity from ISS.
- ICS is physically separated from ISS, and its day-to-day operations are separately managed.
- ISS Global Research team works independently from ICS.
- ICS and ISS staff are forbidden to discuss the identity of ICS clients.
- Institutional analysts' salaries, bonuses and other forms of compensation are not linked to any specific ICS activity or sale.
- ICS explicitly tells its corporate clients and indicates in their contracts that ISS will not give preferential treatment to, and is under no obligation to support, any proxy proposal of an ICS client. ICS further informs its clients that ISS' Global Research team prepares its analyses and vote recommendations independently of, and with no involvement from, ICS.

ISS maintains a robust training and monitoring program regarding the firewall. This program includes quarterly tests of the firewall's integrity, new-hire orientation, and review of certain marketing materials and disclosures. There also is an ethics hotline available to both ICS and ISS staff for reporting issues of potential concern.

b. Other Conflicts

ISS has adopted, implemented and enforces policies and procedures to address other conflict situations as well. Such conflicts also may arise within the institutional advisory business where an ISS client is, itself, a public company whose proxies are the subject of analyses and voting recommendations, or other advisory research reports or where the Company is called upon to analyze and vote on shareholder proposals propounded by a Company client. Or, conflicts may arise from an ISS analyst's stock ownership or in connection with ISS' ownership structure. Finally, issuers' review of draft proxy analyses may give rise to conflicts.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

c. Disclosure Regarding Potential Conflicts

ISS provides its investor clients with an extensive array of information to ensure that they are fully informed of potential conflicts and the steps ISS has taken to address them. In addition to making full disclosure in the Form ADV brochure it delivers to each client, ISS supplies a comprehensive due diligence compliance package on its web site to assist clients and prospective clients in fulfilling their own obligations regarding the use of proxy advisory services. This package includes a copy of ISS' Code of Ethics, a description of other policies, procedures and practices regarding potential conflicts of interest and a description of the ICS business. A copy of the ISS Board of Directors Conflicts of Interest Policy related to Director-Affiliated Companies is also available through the ISS web site.

Moreover, each proxy analysis and research report that ISS issues contains a legend indicating that the subject of the analysis or report may be a client of or affiliated with a client of ISS, ICS or another ISS subsidiary. Each analysis and report also notes that one or more proponents of a shareholder proposal may be a client of ISS or one of its affiliates, or may be affiliated with such a party. Although investment advisers typically disclose conflict of interest information at a macro level,[26] ISS does more. Any institutional client that wishes to learn more about the relationship, if any, between ICS and the subject of a particular analysis or report may contact ISS' Legal and Compliance Department for relevant details. This process allows ISS' proxy voting clients to receive the names of ICS clients without revealing that information to research analysts as they prepare vote recommendations and other research. ISS clients are also provided with details about the amount that each ICS client has paid ICS and the particular products/services they purchased. Were the ICS relationship explicitly identified on the face of, or within, a proxy analysis or report, this critical information barrier would be destroyed.

In addition to obtaining report-by-report conflict information, institutional clients of ISS can obtain lists of all ICS clients. Some clients receive such lists on a monthly basis, while others receive the lists on a quarterly or annual basis. They also obtain a range of additional information regarding our information barriers, our data centers, and other aspects of our operations. Many clients meet with ISS staff on an annual basis to discuss conflicts and other due diligence matters.

B. Proxy Process

In its capacity as a voting agent, each year ISS executes millions of proxy ballots on behalf of its clients. From that vantage point we observe that the current infrastructure for voting proxies is at times inefficient, expensive, and prone to errors. Clarity and transparency can be at times difficult to obtain and there is little competition. We know the market would welcome improvements. There has been a great deal of debate around the use of technology to improve the quality, transparency, efficiency and cost-structure of proxy voting. One approach to open up the market would be to evaluate moving the responsibility

[26] *See, e.g.* Form ADV, Part 2A, Item 11.

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

of proxy distribution from custodians picking the service provider to the companies that are actually issuing the proxies and paying for their distribution.

Below we provide more specific thoughts on potential reforms that we believe would benefit investors.

1. End-to-End Vote Confirmation

End-to-end vote confirmation is the one topic that our clients raise most often in conversations related to the U.S. proxy voting system. ISS clients have continually expressed frustration that there is currently no mechanism whereby a vote for a specific holding can be clearly tracked all the way through the voting process from the time the vote is cast through the time that vote is tabulated and certified.

Unfortunately, very little has changed since we commented on this problem in response to the SEC's 2010 Concept Release.[27] The path between investor and issuer in the proxy voting process remains confusing. This complexity introduces data and process issues that impede the flow of accurate vote confirmation information back up the voting chain to the investor once a vote has been cast; impediments which have not been addressed in the current system of ballot distribution or since the conversations from 2010 on the proxy process.

Data Flow and Process Issues

As we explained in the 2010 Comments, ISS is able to verify only certain parts of the voting process for our clients: (1) that the proxy delivery agent has delivered ballots that match its clients' reported holdings, (2) that the agent has received the voting instructions sent by ISS on behalf of clients, and finally (3) that the agent has delivered the votes, in aggregate, to the tabulator. ISS has no ability to confirm that votes were received and counted. Because many issues can occur from the tabulator to the final vote tally, anything less than a confirmation of that final vote tally is not an end-to-end confirmation. There could be better interim steps than those that currently exist, but the ultimate goal should be getting accurate insight into the final vote tally to ensure there are no under/overvoting or chain of custody issues, which do not get reported to the beneficial owners or their agents with in any standardized or regular manner.

Balancing Investors' Competing Needs for Confirmation and Privacy

On the surface, it appears that in order to allow issuers to confirm to upstream parties that a specific investor's votes have been cast and counted, they, or their agents, would need some level of access to beneficial owner information, which would upend the privacy protections of the OBO/NOBO process.

However, while we understand that many beneficial owners would like to have vote confirmations, it is unclear whether they are willing to compromise the confidentiality of their

[27] Letter from Stephen Harvey, Business Head, ISS to Elizabeth Murphy, Secretary, SEC, (October 20, 2010), available at https://www.sec.gov/comments/s7-14-10/s71410-154.pdf (2010 Comments).

ISS

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

portfolio holdings in order to get such confirmations. In previous client surveys, and other client engagements, institutional investors appear to be roughly split down the middle on this privacy issue. Some investors would trade some degree of privacy in exchange for vote confirmation while others would not. In practice, many of our clients wish not to disclose their ownership positions to outside parties and many investors actively rely on the NOBO/OBO process to achieve that goal.

Proposed Model for Vote Confirmations

While current industry practices create obstacles to vote confirmation, we believe that these obstacles are far from insurmountable. Given the growing importance of proxy voting, the process must be enhanced to allow proxy voting agents, third-party intermediaries and, most importantly, beneficial owners to confirm that in fact the issuer, or its agents, have received and counted their votes properly. Enhancing the process in a way that ensures such confirmation would be a very positive step in furthering the Commission's goals of increased transparency and engagement within the proxy voting process.

To alleviate privacy concerns, we envision that an impartial entity could act as "owner" or "trustee" of vote confirmation data and would either sit between the proxy delivery/voting entities and the issuers or alongside the proxy voting chain. This independent entity would be able to provide a true confirmation back to the beneficial owners and their agents, but still maintain investors' privacy, if they so desire. We believe that a potential paradigm for this structure exists in the Depository Trust and Clearing Corporation (DTCC).

Such vote confirmations should be provided free of charge to the actual voters, as well as their designated agents, and should be done 10 days, 5 days, and one business day prior to the actual voting deadline. This would ensure that any miscast votes, missed votes and/or missing share positions can be rectified in a timely and transparent fashion. All vote confirmations should be readily viewable through electronic means and in a standardized, human and machine-readable format.

In addition, the creation of a standardized, unique identifier for each distinct beneficial owner has the potential to advance the vote confirmation process further. ISS invites other market participants to explore this option, cognizant of some key issues:

- Mappings between omnibus positions and underlying beneficial data would need to be maintained in a highly secure and trusted environment in order to respect investors' desires to keep their positions private.
- Strict oversight and controls would be required, with standard inter-firm procedures across proxy delivery agents, voting agents, issuers, custodians and transfer agents.

As a voting agent for a large number of financial institutions, ISS is already required to adhere to a very strict regimen of audits and controls and we meet with many of our clients on an annual basis for the purposes of compliance with current regulations. ISS, for example, obtains an annual SSAE-18 from an audit firm of national reputation, and has

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

many predefined and well documented internal controls in place to ensure that its mechanisms are working as intended. We are confident that a solution to the vote confirmation can be found that continues to respect the OBO/NOBO system. The information only needs to be unlocked from its current silos.

2. Agenda Disclosure Prior to Record Date

Historically in the U.S. market, in order to vote at a shareholders meeting, investors must own shares on a record date that is typically more than six weeks in advance of the actual meeting date. At the time the meeting and record dates are announced, an issuer does not generally disclose the meeting agenda, which is not released until *after* the record date has passed.

Due to these time lags, investors who participate in share lending often do not have sufficient knowledge about the scope of the meeting to make an informed decision about recalling any shares they may have on loan. Investors are not able to weigh the true economic impact of voting their full share position, including any shares on loan, versus the value of leaving the shares on loan. By the time the agenda is disclosed, the record date has passed, and the investor is unable to recall shares to reclaim voting rights.

To address this problem, ISS favors a system whereby record dates for voting entitlement fall after both (1) the announcement of the meeting date and (2) the disclosure of the meeting agendas and other relevant voting information. Moreover, ISS recommends that record dates fall approximately two weeks after the release of the detailed agendas for meetings, with even more time given in the case of contested elections. Such an early-warning system would encourage increased participation in shareholder meetings, as shareholders would have meaningful opportunities to make informed decisions on recalling shares based on the merits of the issues that will be considered by shareholder at the meeting.

In past surveys of our clients, the overwhelming majority of respondents favored requiring issuers to release their agendas in advance of record dates, more than half favored a two-week window, and more than one-third of respondents said such a change would increase the likelihood of their recalling their shares.

Practical Challenges to Record Date Changes

We recognize that there are practical challenges to any change in the current record date system.

The record date system must provide flexibility for issuers in the case of contested meetings or meetings in which shareholder proposals are pending for which the issuer is seeking no-action relief. In such cases, we believe that a record date "significantly closer" to—but no closer than two weeks prior to – the meeting date would be a reasonable solution. In order to accommodate such a system, issuers would need the ability to change record dates after the initial announcement date, particularly in the case of contested elections.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

As record dates for the establishment of voting entitlements would be set after the release of the meeting date and agenda details, additional checks and balances would need to be established to protect against possible mistakes in proxy mechanics. Specifically, given that the share positions eligible to vote proxies at the time of the initial announcement of the meeting will certainly change by the record date, tools must be implemented to ensure that the final eligible voter lists are reconciled at the time of the record date.

Without proper controls, risks could be introduced into the process that would increase the likelihood of disenfranchising shareholders who are eligible to vote, or allowing shareholders who are ineligible to vote to cast ballots. If unchecked, such flaws could exacerbate over-voting and under-voting. We believe, however, that proper controls are feasible.

We do not believe that a change to the record date system would materially impact loan stability or result in adverse effects on capital markets. Shareholders will continue to look at recalling shares in connection with the proxy voting process based on the economic merits of doing so. The benefit derived from the change will principally be that shareholders will be able to make informed decisions as to whether to recall shares on loan as opposed to the current arrangement, which often forces shareholders to take an "all or nothing" approach to pulling back shares. This benefit would also further the Commission's goals of increasing transparency and engagement as well as reducing the occurrence of "empty voting."

The keys to an advance notice requirement are consistency and simplicity. Rules should be applicable to all issuers in terms of the level of material disclosure and timing. Significant variance among issuers would lead to confusion in the marketplace and increased risk. Optimally, advanced notice would be implemented through both filings with the Commission and web site postings. Using these two media would satisfy the requirements of transparency, accessibility, and sustainability in an increasingly electronic age.

3. Universal Ballot

Current rules for contested meetings allow for the issuance of two or more competing proxy cards, typically with competing lists of nominees for board elections. This system of having a "management ballot" and a "dissident ballot" creates additional impediments to the proxy voting process and can present unique challenges for investors when it comes to deciding which board nominees best represent their interests.

One of the biggest challenges created by this multiple ballot approach is that there currently is no practical mechanism by which an investor can submit votes through any means for nominees from both lists unless the investor attends the meeting in person. In order for an investor to attempt such a vote, known as a "cross-slate vote," there are several hurdles that must be cleared, all of which are cumbersome and require that the voting process be done manually.

Typically, the investor must first obtain consent from the inspector of the election, as well as the issuer's solicitor, to confirm that such a vote will not simply be discarded as invalid.

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

Once the consent has been granted, the investor must then proceed with requesting necessary documentation from the proxy delivery agent that will allow the investor to attend and vote at the meeting, known as a "legal proxy request." The issuance of this documentation can take anywhere from 48-72 hours to complete due to the need for the delivery agent to work with custodians and other intermediaries in the voting process to confirm the holdings data. Once the legal proxies have been issued, the investor must then manually complete a proxy card and then add manual edits to indicate which director nominees from both slates are being chosen. The completed card and the legal proxies are then submitted to the issuer's solicitation agent and the votes are processed manually at the meeting.

Contested Ballot Voting Limits Engagement

The complexity and manual nature of the process introduces multiple risk points into the process, because human error could cause the investor's vote to be miscast or fail to be processed altogether. When clients reach out to ISS to determine the feasibility of submitting a cross-slate vote, they are usually deterred from proceeding once they discover the complexity of the steps involved. As a practical matter, cross-slate voting is not an option for smaller investors.

This leads to a situation where the vote submitted for director nominees becomes a zero-sum affair, even if there may be candidates from both slates that an investor would like to support. This all-or-nothing approach limits shareholder engagement with the issuer and can negatively impact board diversity if shareholders' interests and voting desires are not accurately represented. Enacting rules that allow for shareholders to vote on all nominees or proposals on a single proxy ballot would result in increased engagement between issuers and investors. Having a single voting agenda will make it much easier for investors to accurately represent their interests with regards to both the optimal board composition and other corporate governance items that shareholders may wish to present on meeting agendas.

* * * * *

ISS looks forward to discussing these issues at the upcoming Staff Roundtable on the Proxy Process. We would be happy to supply the Commission or the staff with additional information regarding any of the matters discussed herein. Please direct questions about these comments to the undersigned or to our outside counsel, Mari-Anne Pisarri. She can be reached at 202.223.4418.

Very truly yours,

Gary Retelny
President and CEO

Institutional Shareholder Services Inc.
1177 Avenue of Americas, 2nd Floor
New York, NY 10036
T: +1.646.680.6300 | F: +1.646.417.6090

cc: The Honorable Jay Clayton, Chairman
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
Dalia Blass, Director, Division of Investment Management
William Hinman, Director, Division of Corporation Finance

BON SECOURS MERCY HEALTH

December 5, 2018

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Brown:

Bon Secours Mercy Health has long been concerned not only with the financial returns of our investments, but also with their ethical implications. We believe that a demonstrated corporate responsibility in matters of the environment, and social and governance concerns fosters long-term business success. Excellent and sustainable investment returns are essential for the long-term financial support of Bon Secours Mercy Health.

We are members of the Interfaith Center on Corporate Responsibility (ICCR) and involved in the shareholder resolution process. As such we are concerned about the potential rule changes around ownership thresholds and resubmission thresholds. Shareholder engagements and resolutions brought forward by the faith community have been identified by many corporations as bringing forward longer-term emerging risks with the potential to negatively impact people. They have been seen as an early warning into the future. The history demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions.

The current ownership threshold of $2000 allows an important diversity of investors to be heard. Holding shares for a year ensures that investors are concerned about the long-term value of the company and raising the timing or dollar amount excludes smaller investors from participating in the proposal process. The current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward. Areas such as human rights risks, financial and governance standards and the environment are areas where progress has been seen.

In conclusion, we reiterate support of the shareholder proposal process as currently practiced under Rule 14a-8 and believe making changes that are under consideration to limit resolution filings by investors risk the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected, whether those investors are small or large investors.

Finally, attached is the letter that we sent to the SEC in advance of the SEC roundtable, which describes in more detail our position on potential changes to shareholder processes. We appreciate this opportunity to share our perspectives on the importance of shareholder rights. Thank you for the opportunity to voice our concerns.

Sincerely,

Jon P. Fishpaw

Jon P. Fishpaw
Chief Government Relations Officer

1701 Mercy Health Place | Cincinnati, OH 45237 | BSMHealth.org

November 13, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Rule 14a-8 and Proxy Process Reform

Dear Chairman Clayton:

We, the undersigned investors, representing total assets under management of almost $570 billion, respectfully write to express our views about the importance and benefits of shareholder proposals and proxy voting, and to urge the Securities and Exchange Commission ("SEC") to maintain Rule 14a-8 (the "Rule") as is. We appreciate the opportunity to comment on these matters prior to the SEC's upcoming Roundtable on the Proxy Process on November 15.

We believe that the current rules and thresholds under Rule 14a-8 work well for investors and issuers, and should be maintained. Under Rule 14a-8, a company is required to include shareholder proposals from eligible shareholders in its proxy materials unless the proposals do not meet the eligibility and procedural requirements of the Rule or are subject to exclusion on other bases as set forth therein. Shareholders who rely on the Rule may submit only one proposal per corporate annual meeting and are required to have continuously owned at least $2,000 in market value, or 1%, of an issuer's outstanding voting securities for a year or more by the date the proposal is submitted.

Currently, there are a number of bases upon which a company may rely to exclude shareholder proposals, including the provision of the Rule that governs the resubmission of such proposals. Pursuant to this provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the proposal may be excluded for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third.[1]

Critics of the benefits of shareholder proposals and the manner in which Rule 14a-8 has effectively governed the proposal process express various arguments purporting to justify unnecessary reforms and prohibitive requirements. These proposed new requirements would restrict shareholders' ability to put forth and vote on important proposals. However, the arguments used to justify these new restrictions do not withstand scrutiny.

---

[1] 17 C.F.R. § 240.14a-8(i)(12).

Shareholder Proposals Should Remain Open to Investors of All Sizes

Some critics argue that the SEC makes it too easy for shareholders to submit a proposal. Currently, a shareholder owning $2,000 worth of a company's shares for at least one year is permitted to submit a shareholder proposal. While at one time, ownership of a single share of stock came with the right to submit a proposal, in 1983 the SEC decided it made sense to have a modest but still low requirement, setting the threshold at $1,000 held for at least one year. The SEC in 1998 raised this to $2,000, "to adjust for the effects of inflation," but did not raise it further "in light of rule 14a-8's goal of providing an avenue of communication for small investors."

Such a requirement helps to ensure that smaller, 'Main Street' investors have the same rights to file a proposal as wealthier individuals and institutional investors. As such, the filing threshold ensures a form of shareholder democracy that is open to nearly all investors, as it should be.

Shareholder Proposals Cannot Currently be Re-submitted Too Easily

Critics of Rule 14a-8 suggest that resubmission thresholds should be raised to reduce the number of proposals filed repeatedly for a number of years. The data, however, do not support that re-filings are a problem. According to Institutional Shareholder Services ("ISS") data, from 2010 to 2017, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years. This affected only 26 companies.[2] In other words, resubmission of proposals receiving less than 20% support for a third or fourth time is very rare. Moreover, the current resubmission thresholds create significant pressure on shareholder proponents and a higher threshold would put a high percentage of proposals at risk for exclusion from proxies. The ISS database tracked 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017. Of these proposals, 104 proposals (22.7%) received less than 10% of the For/Against vote. In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.[3]

Experience indicates that it often takes several years for a proposal regarding an emerging issue to gain enough traction with investors to achieve double-digit votes. In many cases, these proposals eventually receive substantial support, leading to widespread adoption by companies.
For example, in 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.[4] The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

[2] ISS Voting Analytics database.
[3] Ibid.
[4] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013

Shareholder Proposals are Not Abused by Activist Investors

Abuse of the proposal process by alleged activist investors is another misguided argument used in favor of restricting shareholders' rights. According to this allegation, a small number of activist investors abuse the system by accounting for a disproportionate volume of proposals. While the ISS database does show that the Chevedden, Steiner, and McRitchie families submitted 14.5% of the 11,706 proposals filed between 2004 and 2017, *the average vote on these proposals was 40%.*[5] This average vote level indicates that these filers provide a valuable service to fellow shareholders by promoting good corporate governance. For example, these investors frequently focus on encouraging companies to adopt best-practice corporate governance reforms such as eliminating supermajority voting requirements, appointing an independent board chair, eliminating staggered boards, and giving shareholders a "say on pay" and "proxy access" to nominate candidates for board elections.[6]

Shareholder Proposals Are Not the Cause of the Reduction in Public Traded Companies

Only a small proportion of proposals are filed at companies with a recent IPO -- less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.[7] Because large companies make up a larger portion of investors' equity portfolios than small companies, larger companies are more likely to receive shareholder proposals. According to the ISS Voting Analytics database, S&P 500 companies received 659 proposals in 2017, which was equal to 77% of the 852 proposals that Russell 3000 companies received.[8] Moreover, only 3.7% of shareholder proposals in the ISS database were filed at companies with a market capitalization below $1 billion.[9]

There are numerous factors contributing to the reduction in the number of public companies in the U.S. According to Vanguard, these include:[10]

- a steep drop in the number of small and micro-firm IPOs compared with the number of IPOs during the tech bubble in the late 1990s. Vanguard explains: "It appears that companies are choosing to be acquired by larger public companies rather than go public themselves."
- In 2016, more than 4,800 private companies were acquired, compared with about 1,950 during the IPO peak in 1996.[11]
- Mergers are also the leading cause (and a generally growing proportion) of delistings.

---

[5] ISS Voting Analytics database.

[6] https://www.lexology.com/library/detail.aspx?g=b6ad9d24-4a68-4736-8b28-3bbbadfbd7f5

[7] ISS Voting Analytics database, and https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf

[8] ISS Voting Analytics database.

[9] Ibid.

[10] https://personal.vanguard.com/pdf/ISGPCA.pdf

[11] https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf

- Overall, Vanguard concludes that "the shrinking number of publicly listed companies consists almost entirely of those [micro] securities that would not have been invested in by active and passive funds anyway."

Vanguard also points out that growth in private equity is outpacing growth in public equity. Contributing to the growth in private funding of companies is a series of regulatory changes. The 1996 Securities Markets Improvement Act made it easier for private companies to sell stock to "qualified purchasers," meaning institutional investors and wealthy individuals.[12] In 2012 Congress boosted the allowed number of investors in large private firms from 500 to 2,000. The SEC also adopted rules to encourage "private placements," allowing private firms to raise millions of dollars while avoiding public reporting.[13] In addition, the growth in investment by mutual funds in late-stage private start-ups is providing resources that help companies delay going public.[14]

Due to these factors, among other macro forces such as low interest rates spurring debt financing,[15] private assets under management grew from less than $1 trillion in 2000 to more than $5 trillion last year. As a result, many companies no longer need an IPO to raise capital.[16]

At the same time, Wall Street fees for small company IPOs tend to be far higher than those paid by large companies. For example, Facebook paid around 1.1%, whereas many small companies pay roughly 7%.[17] SEC Commissioner Jackson labels these fees a "middle-market tax."[18]

These changes in market structure, and the deregulation of private investments, are far more important than shareholder proposals in reducing the number of public companies and offerings. In fact, there is no evidence that shareholder proposals are a factor in reducing IPOs, or in increasing the number of mergers, or companies going private.[19]

Shareholder Proposals Do Not Meaningfully Increase Costs

Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS database.[20] In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.

---

[12] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/
[13] Ibid.
[14] https://corpgov.law.harvard.edu/2017/09/28/the-evolution-of-the-private-equity-market-and-the-decline-in-ipos/ and https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf
[15] Ibid.
[16] Ibid.
[17] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/
[18] Ibod.
[19] https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf, p. 10
[20] Ibid.

Importantly, the cost to companies of the existing shareholder proposal process is generally low (and something companies have control over managing),[21] and the process often results in benefits to companies. As noted, most companies receive few, if any, shareholder proposals. In 2016, there were fewer than 1,000 total shareholder proposals filed at all reporting companies in the U.S.[22] Only half of the proposals submitted by shareholders appear in companies' proxies and, consequently, relatively few companies (fewer than 500 in 2016) held votes on issues submitted by shareholders.[23] This is in part due to meaningful dialogues that happen between investors and management that leads to win/win agreements - resulting in the withdrawal of resolutions. In any given year one quarter to one third of resolutions on environmental and social issues, for example, are withdrawn because of such agreements. And some governance issues like majority vote for directors and access to the proxy result in even higher rates of agreement, making a vote unnecessary.

Finally, the SEC oversees a robust "no-action letter" process that allows companies to exclude proposals from the proxy ballot that do not meet specific procedural or substantive hurdles.

Investors Benefit from the Valuable Services Proxy Advisors Provide to Advance Good Corporate Governance

Some argue that investors over-rely on proxy advisors ISS and Glass Lewis who account for 97% of market share in the industry. The alleged result is that ISS and Glass Lewis functionally control substantial voting shares of thousands of companies in their portfolios, and that this control empowers them to set standards for corporate governance by choosing which shareholder proposals to support.

In fact, while many institutional investors do rely on proxy advisors for advice and administrative help, voting decisions remain the ultimate responsibility of investors. As CII states in their letter to the House Committee on Financial Services, dated Nov 9, 2017:

> *"Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.*
>
> *In short, most large institutional investors vote their proxies according to their own guidelines. While large institutional investors rely on proxy advisors to manage the analysis of issues presented in the proxy statements accompanying over 38,000 meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.*

[21] The Dangerous "Promise of Market Reform": No Shareholder Proposals, Harvard Law School Forum on Corporate Governance and Financial Regulation, Adam Kanzer, 2017
[22] ISS Voting Analytics database.
[23] Ibid.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against say on pay proposals at 11.92 percent of Russell 3000 companies in 2017, only 1.28 percent of those proposals received less than majority support from shareowners.[24] *Similarly, although ISS recommended votes in opposition to the election of 10.43 percent of director-nominees during the most recent proxy season, just 0.185 percent failed to obtain majority support.*"[25]

The Growth of Index Funds is Not Resulting in Too Much Power for Proxy Advisors

Another complaint posits that passive fund managers of index funds do not have the time or incentive to obtain the necessary information about each company whose shares are owned in their funds to be well-informed voters. According to these critics, this problem is becoming more pressing with the growth of index funds. Nearly one-third of equity investment in the United States is via index funds, and index funds are the largest shareholders in 40% of public U.S. companies.[26] As a result, critics claim that passive fund managers' reliance on the advice of proxy advisors cedes shareholder power to, functionally, two firms. As index funds continue to account for more and more of equity ownership, proxy advisors will continue to obtain even more influence over shareholder proposals.

Again, the critics' argument assumes that passive fund managers blindly follow the recommendations of the proxy advisors. These managers almost always have detailed proxy voting guidelines that frequently result in a divergence between their votes and the recommendations of the proxy advisors. For example in 2017, BlackRock and Vanguard voted for 2% of all climate-related shareholder proposals tracked by the non-profit organization Ceres, including many proposals that proxy advisors recommended voting for.[27]

Proxy Advisors Decrease Costs For Investors

Reliance on proxy advisers provides cost savings and market externality benefits to investors. Large, widely diversified institutional investors must manage proxy voting related to up to 38,000 annual meetings globally each year according to CII. Clearly, it is more efficient for most investors to rely on assistance from proxy advisors who can spread some of the costs of voting across thousands of clients than for each institutional investor to try to manage this herculean ask on their own. CII's November 9th 2017 letter to House Financial Services Committee[28] noted that...

---

[24] Ibid.

[25] ISS Voting Analytics Database (last viewed on Oct. 23, 2017 & on file with CII).

[26] Phil Gramm and Mike Solon, "Keep Politics Out of the Boardroom," WALL STREET JOURNAL, July 18, 2018.

[27] https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about

[28] https://www.cii.org/files/issues_and_advocacy/correspondence/2017/Attachment%20to%20December%2012,%202017%20Letter.pdf

... in recent months the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its recently issued report to the President on "A Financial System that Creates Economic Opportunities, Capital Markets." In that report, the Treasury found that 'institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements.' More importantly, the Treasury did not recommend any legislative changes governing the proxy advisory firm industry.[29]

<u>Corporate Managers Benefit From Investor Input on Environmental, Social, and Governance Issues</u>

One complaint argues that the shareholder proposal process is redundant because company management already considers environmental, social and governance (ESG) issues. However, if management already addresses a particular ESG issue set forth by the proposal, investors are far less likely to waste time filing the proposal in the first place, and the proposal can be challenged and rejected as "substantially implemented."

A second complaint concerns an alleged lack of connection between ESG issues and shareholder value. However, the Department of Labor has recognized that ESG issues can be significant:

[T]he Department merely recognized that there could be instances when otherwise collateral ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, these ordinarily collateral issues are themselves appropriate economic considerations, and thus should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments. In other words, in these instances, the factors are more than mere tie-breakers. To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.[30]

In addition, investors such as BlackRock, State Street and more than 1,700 members of the Principles for Responsible Investment have all publicly proclaimed the importance of ESG issues

[29] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets" 31 (Oct. 7, 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-CapitalMarkets-FINAL-FINAL.pdf.
[30] <u>Field Assistance Bulletin 2018-01</u>

to shareholder value.[31] These claims are backed by a robust set of academic research.[32,33] In fact, more than 20% of assets under management in U.S. markets are managed with some form of ESG strategy according to US SIF.[34] Clearly, ESG issues are frequently financially material.

The third and final concern relates to shareholder proposals that are redundant or overlap in content with other proposals filed with same company. In these cases, the SEC already serves as an impartial arbiter using specific guidelines. Under the existing Rule's framework, a company may request to exclude a shareholder proposal that (i) directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting; (ii) the company has already substantially implemented the proposal; and (iii) if the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting.

* * * * *

We do not believe revision of Rule 14a-8 is necessary at this time. The existing Rule currently allows institutional investors of all sizes and individual shareholders alike to engage corporate boards and senior management on their need to address important environmental, social, and governance issues and long-term risk management. Shareholder proposals frequently address emerging systemic risks to the U.S. and globally economies, such as the predatory lending that contributed to the 2008 financial crisis.

The current process also allows investors to communicate with boards, management, and other shareholders about the most effective, proactive way to protect investor interests with respect to corporate governance, risk, and policy issues affecting companies prior to a crisis.

As such, the existing process serves an important self-regulatory function for U.S. capital markets, allowing shareholders a means to protect their interests through a form of shareholder democracy. Additional government interference in this private ordering process is not necessary or advisable.

For these reasons, we oppose further restricting shareholder proposals, which are helpful to companies, investors, and the economy as whole. Thank you for considering these views. We welcome the opportunity to work with you to address these concerns.

Sincerely,

Addenda Capital
Adrian Dominican Sisters, Portfolio Advisory Board
Bailard, Inc
Bon Secours Mercy Health

---

31 https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment
32 https://responsiblebusiness.haas.berkeley.edu/research/moskowitz-past-winners.html
33 https://www.ussif.org/performance
34 https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf

Boston Common Asset Management
CCLA Investment Management
Christopher Reynolds Foundation
Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A.
Congregation of St. Joseph
Connecticut Retirement Plans and Trust Funds
Daughters of Charity, Province of St. Louise
Dignity Health
Educational Foundation of America
Friends Fiduciary Corporation
Green Century Capital Management
Impax Asset Management LLC
Inherent Group, LP
Interfaith Center on Corporate Responsibility
Loring, Wolcott & Coolidge
Maryknoll Sisters
Maryland State Retirement and Pension System
Maryland State Treasurer
McKnight Foundation
Mercy Investment Services, Inc.
Miller/Howard Investments, Inc
Oregon State Treasury
Parametric
Parnassus Investments
Progressive Investment Management
Seattle City Employees' Retirement System
Seventh Generation Interfaith, Inc.
The Episcopal Church USA
Tri-State Coalition for Responsible Investment
Trillium Asset Management
Trinity Health
Unitarian Universalist Association
USA West Province of the Society of Jesus
Walden Asset Management / Boston Trust

Cc: Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Pierce
Commissioner Kara M. Stein
Commissioner Elad L. Roisman

CONGREGATION OF St. Joseph

December 5, 2018

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Brown:

The Congregation of St. Joseph has long been concerned not only with the financial returns of our investments, but also with their ethical implications. We believe that a demonstrated corporate responsibility in matters of the environment, and social and governance concerns fosters long-term business success. Excellent and sustainable investment returns are essential for the long-term financial support of the Congregation of St. Joseph and our many sponsored ministries.

We are members of the Interfaith Center on Corporate Responsibility (ICCR) and involved in the shareholder resolution process. As such we are concerned about the potential rule changes around ownership thresholds and resubmission thresholds. Shareholder engagements and resolutions brought forward by the faith community have been identified by many corporations as bringing forward longer-term emerging risks with the potential to negatively impact people. They have been seen as an early warning into the future. The history demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions.

The current ownership threshold of $2000 allows an important diversity of investors to be heard. Holding shares for a year ensures that investors are concerned about the long-term value of the company and raising the timing or dollar amount excludes smaller investors from participating in the proposal process. The current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward. Areas such as human rights risks, financial and governance standards and the environment are areas where progress has been seen.

In conclusion, we reiterate support of the shareholder proposal process as currently practiced under Rule 14a-8 and believe making changes that are under consideration to limit resolution filings by investors risk the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected, whether those investors are small or large investors.

Finally, attached is the letter that we sent to the SEC in advance of the SEC roundtable, which describes in more detail our position on potential changes to shareholder processes. We appreciate this opportunity to share our perspectives on the importance of shareholder rights. Thank you for the opportunity to voice our concerns.

Sincerely,

Karen Watson, CFA
Chief Investment Officer

November 13, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Rule 14a-8 and Proxy Process Reform

Dear Chairman Clayton:

We, the undersigned investors, representing total assets under management of almost $570 billion, respectfully write to express our views about the importance and benefits of shareholder proposals and proxy voting, and to urge the Securities and Exchange Commission ("SEC") to maintain Rule 14a-8 (the "Rule") as is. We appreciate the opportunity to comment on these matters prior to the SEC's upcoming Roundtable on the Proxy Process on November 15.

We believe that the current rules and thresholds under Rule 14a-8 work well for investors and issuers, and should be maintained. Under Rule 14a-8, a company is required to include shareholder proposals from eligible shareholders in its proxy materials unless the proposals do not meet the eligibility and procedural requirements of the Rule or are subject to exclusion on other bases as set forth therein. Shareholders who rely on the Rule may submit only one proposal per corporate annual meeting and are required to have continuously owned at least $2,000 in market value, or 1%, of an issuer's outstanding voting securities for a year or more by the date the proposal is submitted.

Currently, there are a number of bases upon which a company may rely to exclude shareholder proposals, including the provision of the Rule that governs the resubmission of such proposals. Pursuant to this provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the proposal may be excluded for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third.[1]

Critics of the benefits of shareholder proposals and the manner in which Rule 14a-8 has effectively governed the proposal process express various arguments purporting to justify unnecessary reforms and prohibitive requirements. These proposed new requirements would restrict shareholders' ability to put forth and vote on important proposals. However, the arguments used to justify these new restrictions do not withstand scrutiny.

[1] 17 C.F.R. § 240.14a-8(i)(12).

Shareholder Proposals Should Remain Open to Investors of All Sizes

Some critics argue that the SEC makes it too easy for shareholders to submit a proposal. Currently, a shareholder owning $2,000 worth of a company's shares for at least one year is permitted to submit a shareholder proposal. While at one time, ownership of a single share of stock came with the right to submit a proposal, in 1983 the SEC decided it made sense to have a modest but still low requirement, setting the threshold at $1,000 held for at least one year. The SEC in 1998 raised this to $2,000, "to adjust for the effects of inflation," but did not raise it further "in light of rule 14a-8's goal of providing an avenue of communication for small investors."

Such a requirement helps to ensure that smaller, 'Main Street' investors have the same rights to file a proposal as wealthier individuals and institutional investors. As such, the filing threshold ensures a form of shareholder democracy that is open to nearly all investors, as it should be.

Shareholder Proposals Cannot Currently be Re-submitted Too Easily

Critics of Rule 14a-8 suggest that resubmission thresholds should be raised to reduce the number of proposals filed repeatedly for a number of years. The data, however, do not support that re-filings are a problem. According to Institutional Shareholder Services ("ISS") data, from 2010 to 2017, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years. This affected only 26 companies.[2] In other words, resubmission of proposals receiving less than 20% support for a third or fourth time is very rare. Moreover, the current resubmission thresholds create significant pressure on shareholder proponents and a higher threshold would put a high percentage of proposals at risk for exclusion from proxies. The ISS database tracked 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017. Of these proposals, 104 proposals (22.7%) received less than 10% of the For/Against vote. In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.[3]

Experience indicates that it often takes several years for a proposal regarding an emerging issue to gain enough traction with investors to achieve double-digit votes. In many cases, these proposals eventually receive substantial support, leading to widespread adoption by companies.
For example, in 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.[4] The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

[2] ISS Voting Analytics database.

[3] Ibid.

[4] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013

Shareholder Proposals are Not Abused by Activist Investors

Abuse of the proposal process by alleged activist investors is another misguided argument used in favor of restricting shareholders' rights. According to this allegation, a small number of activist investors abuse the system by accounting for a disproportionate volume of proposals. While the ISS database does show that the Chevedden, Steiner, and McRitchie families submitted 14.5% of the 11,706 proposals filed between 2004 and 2017, *the average vote on these proposals was 40%.*[5] This average vote level indicates that these filers provide a valuable service to fellow shareholders by promoting good corporate governance. For example, these investors frequently focus on encouraging companies to adopt best-practice corporate governance reforms such as eliminating supermajority voting requirements, appointing an independent board chair, eliminating staggered boards, and giving shareholders a "say on pay" and "proxy access" to nominate candidates for board elections.[6]

Shareholder Proposals Are Not the Cause of the Reduction in Public Traded Companies

Only a small proportion of proposals are filed at companies with a recent IPO -- less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.[7] Because large companies make up a larger portion of investors' equity portfolios than small companies, larger companies are more likely to receive shareholder proposals. According to the ISS Voting Analytics database, S&P 500 companies received 659 proposals in 2017, which was equal to 77% of the 852 proposals that Russell 3000 companies received.[8] Moreover, only 3.7% of shareholder proposals in the ISS database were filed at companies with a market capitalization below $1 billion.[9]

There are numerous factors contributing to the reduction in the number of public companies in the U.S. According to Vanguard, these include:[10]

- a steep drop in the number of small and micro-firm IPOs compared with the number of IPOs during the tech bubble in the late 1990s. Vanguard explains: "It appears that companies are choosing to be acquired by larger public companies rather than go public themselves."
- In 2016, more than 4,800 private companies were acquired, compared with about 1,950 during the IPO peak in 1996.[11]
- Mergers are also the leading cause (and a generally growing proportion) of delistings.

---

[5] ISS Voting Analytics database.

[6] https://www.lexology.com/library/detail.aspx?g=b6ad9d24-4a68-4736-8b28-3bbbadfbd7f5

[7] ISS Voting Analytics database, and https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf

[8] ISS Voting Analytics database.

[9] Ibid.

[10] https://personal.vanguard.com/pdf/ISGPCA.pdf

[11] https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf

- Overall, Vanguard concludes that "the shrinking number of publicly listed companies consists almost entirely of those [micro] securities that would not have been invested in by active and passive funds anyway."

Vanguard also points out that growth in private equity is outpacing growth in public equity. Contributing to the growth in private funding of companies is a series of regulatory changes. The 1996 Securities Markets Improvement Act made it easier for private companies to sell stock to "qualified purchasers," meaning institutional investors and wealthy individuals.[12] In 2012 Congress boosted the allowed number of investors in large private firms from 500 to 2,000. The SEC also adopted rules to encourage "private placements," allowing private firms to raise millions of dollars while avoiding public reporting.[13] In addition, the growth in investment by mutual funds in late-stage private start-ups is providing resources that help companies delay going public.[14]

Due to these factors, among other macro forces such as low interest rates spurring debt financing,[15] private assets under management grew from less than $1 trillion in 2000 to more than $5 trillion last year. As a result, many companies no longer need an IPO to raise capital.[16]

At the same time, Wall Street fees for small company IPOs tend to be far higher than those paid by large companies. For example, Facebook paid around 1.1%, whereas many small companies pay roughly 7%.[17] SEC Commissioner Jackson labels these fees a "middle-market tax."[18]

These changes in market structure, and the deregulation of private investments, are far more important than shareholder proposals in reducing the number of public companies and offerings. In fact, there is no evidence that shareholder proposals are a factor in reducing IPOs, or in increasing the number of mergers, or companies going private.[19]

Shareholder Proposals Do Not Meaningfully Increase Costs

Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS database.[20] In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.

---

[12] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/
[13] Ibid.
[14] https://corpgov.law.harvard.edu/2017/09/28/the-evolution-of-the-private-equity-market-and-the-decline-in-ipos/ and https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf
[15] Ibid.
[16] Ibid.
[17] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/
[18] Ibod.
[19] https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf, p. 10
[20] Ibid.

Importantly, the cost to companies of the existing shareholder proposal process is generally low (and something companies have control over managing),[21] and the process often results in benefits to companies. As noted, most companies receive few, if any, shareholder proposals. In 2016, there were fewer than 1,000 total shareholder proposals filed at all reporting companies in the U.S.[22] Only half of the proposals submitted by shareholders appear in companies' proxies and, consequently, relatively few companies (fewer than 500 in 2016) held votes on issues submitted by shareholders.[23] This is in part due to meaningful dialogues that happen between investors and management that leads to win/win agreements - resulting in the withdrawal of resolutions. In any given year one quarter to one third of resolutions on environmental and social issues, for example, are withdrawn because of such agreements. And some governance issues like majority vote for directors and access to the proxy result in even higher rates of agreement, making a vote unnecessary.

Finally, the SEC oversees a robust "no-action letter" process that allows companies to exclude proposals from the proxy ballot that do not meet specific procedural or substantive hurdles.

Investors Benefit from the Valuable Services Proxy Advisors Provide to Advance Good Corporate Governance

Some argue that investors over-rely on proxy advisors ISS and Glass Lewis who account for 97% of market share in the industry. The alleged result is that ISS and Glass Lewis functionally control substantial voting shares of thousands of companies in their portfolios, and that this control empowers them to set standards for corporate governance by choosing which shareholder proposals to support.

In fact, while many institutional investors do rely on proxy advisors for advice and administrative help, voting decisions remain the ultimate responsibility of investors. As CII states in their letter to the House Committee on Financial Services, dated Nov 9, 2017:

> *"Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.*
>
> *In short, most large institutional investors vote their proxies according to their own guidelines. While large institutional investors rely on proxy advisors to manage the analysis of issues presented in the proxy statements accompanying over 38,000 meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.*

---

[21] The Dangerous "Promise of Market Reform": No Shareholder Proposals, Harvard Law School Forum on Corporate Governance and Financial Regulation, Adam Kanzer, 2017

[22] ISS Voting Analytics database.

[23] Ibid.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against say on pay proposals at 11.92 percent of Russell 3000 companies in 2017, only 1.28 percent of those proposals received less than majority support from shareowners.[24] *Similarly, although ISS recommended votes in opposition to the election of 10.43 percent of director-nominees during the most recent proxy season, just 0.185 percent failed to obtain majority support."*[25]

<u>The Growth of Index Funds is Not Resulting in Too Much Power for Proxy Advisors</u>

Another complaint posits that passive fund managers of index funds do not have the time or incentive to obtain the necessary information about each company whose shares are owned in their funds to be well-informed voters. According to these critics, this problem is becoming more pressing with the growth of index funds. Nearly one-third of equity investment in the United States is via index funds, and index funds are the largest shareholders in 40% of public U.S. companies.[26] As a result, critics claim that passive fund managers' reliance on the advice of proxy advisors cedes shareholder power to, functionally, two firms. As index funds continue to account for more and more of equity ownership, proxy advisors will continue to obtain even more influence over shareholder proposals.

Again, the critics' argument assumes that passive fund managers blindly follow the recommendations of the proxy advisors. These managers almost always have detailed proxy voting guidelines that frequently result in a divergence between their votes and the recommendations of the proxy advisors. For example in 2017, BlackRock and Vanguard voted for 2% of all climate-related shareholder proposals tracked by the non-profit organization Ceres, including many proposals that proxy advisors recommended voting for.[27]

<u>Proxy Advisors Decrease Costs For Investors</u>

Reliance on proxy advisers provides cost savings and market externality benefits to investors. Large, widely diversified institutional investors must manage proxy voting related to up to 38,000 annual meetings globally each year according to CII. Clearly, it is more efficient for most investors to rely on assistance from proxy advisors who can spread some of the costs of voting across thousands of clients than for each institutional investor to try to manage this herculean ask on their own. CII's November 9th 2017 letter to House Financial Services Committee[28] noted that...

---

[24] Ibid.

[25] ISS Voting Analytics Database (last viewed on Oct. 23, 2017 & on file with CII).

[26] Phil Gramm and Mike Solon, "Keep Politics Out of the Boardroom," WALL STREET JOURNAL, July 18, 2018.

[27] https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about

[28] https://www.cii.org/files/issues_and_advocacy/correspondence/2017/Attachment%20to%20December%2012,%202017%20Letter.pdf

... in recent months the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its recently issued report to the President on "A Financial System that Creates Economic Opportunities, Capital Markets." In that report, the Treasury found that 'institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements.' More importantly, the Treasury did not recommend any legislative changes governing the proxy advisory firm industry.[29]

Corporate Managers Benefit From Investor Input on Environmental, Social, and Governance Issues

One complaint argues that the shareholder proposal process is redundant because company management already considers environmental, social and governance (ESG) issues. However, if management already addresses a particular ESG issue set forth by the proposal, investors are far less likely to waste time filing the proposal in the first place, and the proposal can be challenged and rejected as "substantially implemented."

A second complaint concerns an alleged lack of connection between ESG issues and shareholder value. However, the Department of Labor has recognized that ESG issues can be significant:

[T]he Department merely recognized that there could be instances when otherwise collateral ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, these ordinarily collateral issues are themselves appropriate economic considerations, and thus should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments. In other words, in these instances, the factors are more than mere tie-breakers. To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.[30]

In addition, investors such as BlackRock, State Street and more than 1,700 members of the Principles for Responsible Investment have all publicly proclaimed the importance of ESG issues

[29] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets" 31 (Oct. 7, 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-CapitalMarkets-FINAL-FINAL.pdf.
[30] Field Assistance Bulletin 2018-01

to shareholder value.[31] These claims are backed by a robust set of academic research.[32,33] In fact, more than 20% of assets under management in U.S. markets are managed with some form of ESG strategy according to US SIF.[34] Clearly, ESG issues are frequently financially material.

The third and final concern relates to shareholder proposals that are redundant or overlap in content with other proposals filed with same company. In these cases, the SEC already serves as an impartial arbiter using specific guidelines. Under the existing Rule's framework, a company may request to exclude a shareholder proposal that (i) directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting; (ii) the company has already substantially implemented the proposal; and (iii) if the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting.

* * * * *

We do not believe revision of Rule 14a-8 is necessary at this time. The existing Rule currently allows institutional investors of all sizes and individual shareholders alike to engage corporate boards and senior management on their need to address important environmental, social, and governance issues and long-term risk management. Shareholder proposals frequently address emerging systemic risks to the U.S. and globally economies, such as the predatory lending that contributed to the 2008 financial crisis.

The current process also allows investors to communicate with boards, management, and other shareholders about the most effective, proactive way to protect investor interests with respect to corporate governance, risk, and policy issues affecting companies prior to a crisis.

As such, the existing process serves an important self-regulatory function for U.S. capital markets, allowing shareholders a means to protect their interests through a form of shareholder democracy. Additional government interference in this private ordering process is not necessary or advisable.

For these reasons, we oppose further restricting shareholder proposals, which are helpful to companies, investors, and the economy as whole. Thank you for considering these views. We welcome the opportunity to work with you to address these concerns.

Sincerely,

Addenda Capital
Adrian Dominican Sisters, Portfolio Advisory Board
Bailard, Inc
Bon Secours Mercy Health

31 https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment
32 https://responsiblebusiness.haas.berkeley.edu/research/moskowitz-past-winners.html
33 https://www.ussif.org/performance
34 https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf

Boston Common Asset Management
CCLA Investment Management
Christopher Reynolds Foundation
Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A.
Congregation of St. Joseph
Connecticut Retirement Plans and Trust Funds
Daughters of Charity, Province of St. Louise
Dignity Health
Educational Foundation of America
Friends Fiduciary Corporation
Green Century Capital Management
Impax Asset Management LLC
Inherent Group, LP
Interfaith Center on Corporate Responsibility
Loring, Wolcott & Coolidge
Maryknoll Sisters
Maryland State Retirement and Pension System
Maryland State Treasurer
McKnight Foundation
Mercy Investment Services, Inc.
Miller/Howard Investments, Inc
Oregon State Treasury
Parametric
Parnassus Investments
Progressive Investment Management
Seattle City Employees' Retirement System
Seventh Generation Interfaith, Inc.
The Episcopal Church USA
Tri-State Coalition for Responsible Investment
Trillium Asset Management
Trinity Health
Unitarian Universalist Association
USA West Province of the Society of Jesus
Walden Asset Management / Boston Trust

Cc: Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Pierce
Commissioner Kara M. Stein
Commissioner Elad L. Roisman

DAUGHTERS
of CHARITY

December 6, 2018

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Brown:

The Daughters of Charity, Province of St. Louise has long been concerned not only with the financial returns of our investments, but also with their ethical implications. We believe that a demonstrated corporate responsibility in matters of the environment, and social and governance concerns fosters long-term business success. Excellent and sustainable investment returns are essential for the long-term financial support of the Daughters of Charity, Province of St. Louise, and our many sponsored ministries.

We are members of the Interfaith Center on Corporate Responsibility (ICCR) and involved in the shareholder resolution process. As such we are concerned about the potential rule changes around ownership thresholds and resubmission thresholds. Shareholder engagements and resolutions brought forward by the faith community have been identified by many corporations as bringing forward longer-term emerging risks with the potential to negatively impact people. They have been seen as an early warning into the future. The history demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions.

The current ownership threshold of $2000 allows an important diversity of investors to be heard. Holding shares for a year ensures that investors are concerned about the long-term value of the company and raising the timing or dollar amount excludes smaller investors from participating in the proposal process. The current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward. Areas such as human rights risks, financial and governance standards and the environment are areas where progress has been seen.

In conclusion, we reiterate support of the shareholder proposal process as currently practiced under Rule 14a-8 and believe making changes that are under consideration to limit resolution filings by investors risk the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected, whether those investors are small or large investors.

Finally, attached is the letter that we sent to the SEC in advance of the SEC roundtable, which describes in more detail our position on potential changes to shareholder processes. We appreciate this opportunity to share our perspectives on the importance of shareholder rights. Thank you for the opportunity to voice our concerns.

Sincerely,

Sister Teresa George

Sister Teresa George, D.C.
Treasurer

DAUGHTERS OF CHARITY, INC.
4330 Olive Street
St. Louis, Missouri 63108-2622

p 314 533 4770
f 314 533 3226
www.daughtersofcharity.org

November 13, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Rule 14a-8 and Proxy Process Reform

Dear Chairman Clayton:

We, the undersigned investors, representing total assets under management of almost $570 billion, respectfully write to express our views about the importance and benefits of shareholder proposals and proxy voting, and to urge the Securities and Exchange Commission ("SEC") to maintain Rule 14a-8 (the "Rule") as is. We appreciate the opportunity to comment on these matters prior to the SEC's upcoming Roundtable on the Proxy Process on November 15.

We believe that the current rules and thresholds under Rule 14a-8 work well for investors and issuers, and should be maintained. Under Rule 14a-8, a company is required to include shareholder proposals from eligible shareholders in its proxy materials unless the proposals do not meet the eligibility and procedural requirements of the Rule or are subject to exclusion on other bases as set forth therein. Shareholders who rely on the Rule may submit only one proposal per corporate annual meeting and are required to have continuously owned at least $2,000 in market value, or 1%, of an issuer's outstanding voting securities for a year or more by the date the proposal is submitted.

Currently, there are a number of bases upon which a company may rely to exclude shareholder proposals, including the provision of the Rule that governs the resubmission of such proposals. Pursuant to this provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the proposal may be excluded for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third.[1]

Critics of the benefits of shareholder proposals and the manner in which Rule 14a-8 has effectively governed the proposal process express various arguments purporting to justify unnecessary reforms and prohibitive requirements. These proposed new requirements would restrict shareholders' ability to put forth and vote on important proposals. However, the arguments used to justify these new restrictions do not withstand scrutiny.

---

[1] 17 C.F.R. § 240.14a-8(i)(12).

Shareholder Proposals Should Remain Open to Investors of All Sizes

Some critics argue that the SEC makes it too easy for shareholders to submit a proposal. Currently, a shareholder owning $2,000 worth of a company's shares for at least one year is permitted to submit a shareholder proposal. While at one time, ownership of a single share of stock came with the right to submit a proposal, in 1983 the SEC decided it made sense to have a modest but still low requirement, setting the threshold at $1,000 held for at least one year. The SEC in 1998 raised this to $2,000, "to adjust for the effects of inflation," but did not raise it further "in light of rule 14a-8's goal of providing an avenue of communication for small investors."

Such a requirement helps to ensure that smaller, 'Main Street' investors have the same rights to file a proposal as wealthier individuals and institutional investors. As such, the filing threshold ensures a form of shareholder democracy that is open to nearly all investors, as it should be.

Shareholder Proposals Cannot Currently be Re-submitted Too Easily

Critics of Rule 14a-8 suggest that resubmission thresholds should be raised to reduce the number of proposals filed repeatedly for a number of years. The data, however, do not support that re-filings are a problem. According to Institutional Shareholder Services ("ISS") data, from 2010 to 2017, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years. This affected only 26 companies.[2] In other words, resubmission of proposals receiving less than 20% support for a third or fourth time is very rare. Moreover, the current resubmission thresholds create significant pressure on shareholder proponents and a higher threshold would put a high percentage of proposals at risk for exclusion from proxies. The ISS database tracked 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017. Of these proposals, 104 proposals (22.7%) received less than 10% of the For/Against vote. In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.[3]

Experience indicates that it often takes several years for a proposal regarding an emerging issue to gain enough traction with investors to achieve double-digit votes. In many cases, these proposals eventually receive substantial support, leading to widespread adoption by companies.
For example, in 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.[4] The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

---

[2] ISS Voting Analytics database.

[3] Ibid.

[4] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013

Shareholder Proposals are Not Abused by Activist Investors

Abuse of the proposal process by alleged activist investors is another misguided argument used in favor of restricting shareholders' rights. According to this allegation, a small number of activist investors abuse the system by accounting for a disproportionate volume of proposals. While the ISS database does show that the Chevedden, Steiner, and McRitchie families submitted 14.5% of the 11,706 proposals filed between 2004 and 2017, *the average vote on these proposals was 40%.*[5] This average vote level indicates that these filers provide a valuable service to fellow shareholders by promoting good corporate governance. For example, these investors frequently focus on encouraging companies to adopt best-practice corporate governance reforms such as eliminating supermajority voting requirements, appointing an independent board chair, eliminating staggered boards, and giving shareholders a "say on pay" and "proxy access" to nominate candidates for board elections.[6]

Shareholder Proposals Are Not the Cause of the Reduction in Public Traded Companies

Only a small proportion of proposals are filed at companies with a recent IPO -- less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.[7] Because large companies make up a larger portion of investors' equity portfolios than small companies, larger companies are more likely to receive shareholder proposals. According to the ISS Voting Analytics database, S&P 500 companies received 659 proposals in 2017, which was equal to 77% of the 852 proposals that Russell 3000 companies received.[8] Moreover, only 3.7% of shareholder proposals in the ISS database were filed at companies with a market capitalization below $1 billion.[9]

There are numerous factors contributing to the reduction in the number of public companies in the U.S. According to Vanguard, these include:[10]

- a steep drop in the number of small and micro-firm IPOs compared with the number of IPOs during the tech bubble in the late 1990s. Vanguard explains: "It appears that companies are choosing to be acquired by larger public companies rather than go public themselves."
- In 2016, more than 4,800 private companies were acquired, compared with about 1,950 during the IPO peak in 1996.[11]
- Mergers are also the leading cause (and a generally growing proportion) of delistings.

---

[5] ISS Voting Analytics database.

[6] https://www.lexology.com/library/detail.aspx?g=b6ad9d24-4a68-4736-8b28-3bbbadfbd7f5

[7] ISS Voting Analytics database, and https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf

[8] ISS Voting Analytics database.

[9] Ibid.

[10] https://personal.vanguard.com/pdf/ISGPCA.pdf

[11] https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf

- Overall, Vanguard concludes that "the shrinking number of publicly listed companies consists almost entirely of those [micro] securities that would not have been invested in by active and passive funds anyway."

Vanguard also points out that growth in private equity is outpacing growth in public equity. Contributing to the growth in private funding of companies is a series of regulatory changes. The 1996 Securities Markets Improvement Act made it easier for private companies to sell stock to "qualified purchasers," meaning institutional investors and wealthy individuals.[12] In 2012 Congress boosted the allowed number of investors in large private firms from 500 to 2,000. The SEC also adopted rules to encourage "private placements," allowing private firms to raise millions of dollars while avoiding public reporting.[13] In addition, the growth in investment by mutual funds in late-stage private start-ups is providing resources that help companies delay going public.[14]

Due to these factors, among other macro forces such as low interest rates spurring debt financing,[15] private assets under management grew from less than $1 trillion in 2000 to more than $5 trillion last year. As a result, many companies no longer need an IPO to raise capital.[16]

At the same time, Wall Street fees for small company IPOs tend to be far higher than those paid by large companies. For example, Facebook paid around 1.1%, whereas many small companies pay roughly 7%.[17] SEC Commissioner Jackson labels these fees a "middle-market tax."[18]

These changes in market structure, and the deregulation of private investments, are far more important than shareholder proposals in reducing the number of public companies and offerings. In fact, there is no evidence that shareholder proposals are a factor in reducing IPOs, or in increasing the number of mergers, or companies going private.[19]

Shareholder Proposals Do Not Meaningfully Increase Costs

Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS database.[20] In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.

---

[12] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/

[13] Ibid.

[14] https://corpgov.law.harvard.edu/2017/09/28/the-evolution-of-the-private-equity-market-and-the-decline-in-ipos/ and https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf

[15] Ibid.

[16] Ibid.

[17] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/

[18] Ibod.

[19] https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf, p. 10

[20] Ibid.

Importantly, the cost to companies of the existing shareholder proposal process is generally low (and something companies have control over managing),[21] and the process often results in benefits to companies. As noted, most companies receive few, if any, shareholder proposals. In 2016, there were fewer than 1,000 total shareholder proposals filed at all reporting companies in the U.S.[22] Only half of the proposals submitted by shareholders appear in companies' proxies and, consequently, relatively few companies (fewer than 500 in 2016) held votes on issues submitted by shareholders.[23] This is in part due to meaningful dialogues that happen between investors and management that leads to win/win agreements - resulting in the withdrawal of resolutions. In any given year one quarter to one third of resolutions on environmental and social issues, for example, are withdrawn because of such agreements. And some governance issues like majority vote for directors and access to the proxy result in even higher rates of agreement, making a vote unnecessary.

Finally, the SEC oversees a robust "no-action letter" process that allows companies to exclude proposals from the proxy ballot that do not meet specific procedural or substantive hurdles.

Investors Benefit from the Valuable Services Proxy Advisors Provide to Advance Good Corporate Governance

Some argue that investors over-rely on proxy advisors ISS and Glass Lewis who account for 97% of market share in the industry. The alleged result is that ISS and Glass Lewis functionally control substantial voting shares of thousands of companies in their portfolios, and that this control empowers them to set standards for corporate governance by choosing which shareholder proposals to support.

In fact, while many institutional investors do rely on proxy advisors for advice and administrative help, voting decisions remain the ultimate responsibility of investors. As CII states in their letter to the House Committee on Financial Services, dated Nov 9, 2017:

> *"Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.*
>
> *In short, most large institutional investors vote their proxies according to their own guidelines. While large institutional investors rely on proxy advisors to manage the analysis of issues presented in the proxy statements accompanying over 38,000 meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.*

[21] The Dangerous "Promise of Market Reform": No Shareholder Proposals, Harvard Law School Forum on Corporate Governance and Financial Regulation, Adam Kanzer, 2017

[22] ISS Voting Analytics database.

[23] Ibid.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against say on pay proposals at 11.92 percent of Russell 3000 companies in 2017, only 1.28 percent of those proposals received less than majority support from shareowners.[24] Similarly, although ISS recommended votes in opposition to the election of 10.43 percent of director-nominees during the most recent proxy season, just 0.185 percent failed to obtain majority support."[25]

The Growth of Index Funds is Not Resulting in Too Much Power for Proxy Advisors

Another complaint posits that passive fund managers of index funds do not have the time or incentive to obtain the necessary information about each company whose shares are owned in their funds to be well-informed voters. According to these critics, this problem is becoming more pressing with the growth of index funds. Nearly one-third of equity investment in the United States is via index funds, and index funds are the largest shareholders in 40% of public U.S. companies.[26] As a result, critics claim that passive fund managers' reliance on the advice of proxy advisors cedes shareholder power to, functionally, two firms. As index funds continue to account for more and more of equity ownership, proxy advisors will continue to obtain even more influence over shareholder proposals.

Again, the critics' argument assumes that passive fund managers blindly follow the recommendations of the proxy advisors. These managers almost always have detailed proxy voting guidelines that frequently result in a divergence between their votes and the recommendations of the proxy advisors. For example in 2017, BlackRock and Vanguard voted for 2% of all climate-related shareholder proposals tracked by the non-profit organization Ceres, including many proposals that proxy advisors recommended voting for.[27]

Proxy Advisors Decrease Costs For Investors

Reliance on proxy advisers provides cost savings and market externality benefits to investors. Large, widely diversified institutional investors must manage proxy voting related to up to 38,000 annual meetings globally each year according to CII. Clearly, it is more efficient for most investors to rely on assistance from proxy advisors who can spread some of the costs of voting across thousands of clients than for each institutional investor to try to manage this herculean ask on their own. CII's November 9th 2017 letter to House Financial Services Committee[28] noted that...

---

[24] Ibid.

[25] ISS Voting Analytics Database (last viewed on Oct. 23, 2017 & on file with CII).

[26] Phil Gramm and Mike Solon, "Keep Politics Out of the Boardroom," WALL STREET JOURNAL, July 18, 2018.

[27] https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about

[28] https://www.cii.org/files/issues_and_advocacy/correspondence/2017/Attachment%20to%20December%2012,%202017%20Letter.pdf

... in recent months the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its recently issued report to the President on "A Financial System that Creates Economic Opportunities, Capital Markets." In that report, the Treasury found that 'institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements.' More importantly, the Treasury did not recommend any legislative changes governing the proxy advisory firm industry.[29]

Corporate Managers Benefit From Investor Input on Environmental, Social, and Governance Issues

One complaint argues that the shareholder proposal process is redundant because company management already considers environmental, social and governance (ESG) issues. However, if management already addresses a particular ESG issue set forth by the proposal, investors are far less likely to waste time filing the proposal in the first place, and the proposal can be challenged and rejected as "substantially implemented."

A second complaint concerns an alleged lack of connection between ESG issues and shareholder value. However, the Department of Labor has recognized that ESG issues can be significant:

[T]he Department merely recognized that there could be instances when otherwise collateral ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, these ordinarily collateral issues are themselves appropriate economic considerations, and thus should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments. In other words, in these instances, the factors are more than mere tie-breakers. To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.[30]

In addition, investors such as BlackRock, State Street and more than 1,700 members of the Principles for Responsible Investment have all publicly proclaimed the importance of ESG issues

[29] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets" 31 (Oct. 7, 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-CapitalMarkets-FINAL-FINAL.pdf.

[30] Field Assistance Bulletin 2018-01

to shareholder value.[31] These claims are backed by a robust set of academic research.[32,33] In fact, more than 20% of assets under management in U.S. markets are managed with some form of ESG strategy according to US SIF.[34] Clearly, ESG issues are frequently financially material.

The third and final concern relates to shareholder proposals that are redundant or overlap in content with other proposals filed with same company. In these cases, the SEC already serves as an impartial arbiter using specific guidelines. Under the existing Rule's framework, a company may request to exclude a shareholder proposal that (i) directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting; (ii) the company has already substantially implemented the proposal; and (iii) if the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting.

* * * * *

We do not believe revision of Rule 14a-8 is necessary at this time. The existing Rule currently allows institutional investors of all sizes and individual shareholders alike to engage corporate boards and senior management on their need to address important environmental, social, and governance issues and long-term risk management. Shareholder proposals frequently address emerging systemic risks to the U.S. and globally economies, such as the predatory lending that contributed to the 2008 financial crisis.

The current process also allows investors to communicate with boards, management, and other shareholders about the most effective, proactive way to protect investor interests with respect to corporate governance, risk, and policy issues affecting companies prior to a crisis.

As such, the existing process serves an important self-regulatory function for U.S. capital markets, allowing shareholders a means to protect their interests through a form of shareholder democracy. Additional government interference in this private ordering process is not necessary or advisable.

For these reasons, we oppose further restricting shareholder proposals, which are helpful to companies, investors, and the economy as whole. Thank you for considering these views. We welcome the opportunity to work with you to address these concerns.

Sincerely,

Addenda Capital
Adrian Dominican Sisters, Portfolio Advisory Board
Bailard, Inc
Bon Secours Mercy Health

[31] https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment

[32] https://responsiblebusiness.haas.berkeley.edu/research/moskowitz-past-winners.html

[33] https://www.ussif.org/performance

[34] https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf

Boston Common Asset Management
CCLA Investment Management
Christopher Reynolds Foundation
Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A.
Congregation of St. Joseph
Connecticut Retirement Plans and Trust Funds
Daughters of Charity, Province of St. Louise
Dignity Health
Educational Foundation of America
Friends Fiduciary Corporation
Green Century Capital Management
Impax Asset Management LLC
Inherent Group, LP
Interfaith Center on Corporate Responsibility
Loring, Wolcott & Coolidge
Maryknoll Sisters
Maryland State Retirement and Pension System
Maryland State Treasurer
McKnight Foundation
Mercy Investment Services, Inc.
Miller/Howard Investments, Inc
Oregon State Treasury
Parametric
Parnassus Investments
Progressive Investment Management
Seattle City Employees' Retirement System
Seventh Generation Interfaith, Inc.
The Episcopal Church USA
Tri-State Coalition for Responsible Investment
Trillium Asset Management
Trinity Health
Unitarian Universalist Association
USA West Province of the Society of Jesus
Walden Asset Management / Boston Trust

Cc: Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Pierce
Commissioner Kara M. Stein
Commissioner Elad L. Roisman

December 3, 2018

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, D.C. 20510

Re: <u>Proxy Process and Rules: Examining Current Practices and Potential Changes</u>

Dear Senator Brown:

Mercy Investment Services, Inc., as the investment program of the Sisters of Mercy of the Americas, has long been concerned not only with the financial returns of its investments, but also with the ethical implications of its investments. We believe that a demonstrated corporate responsibility in matters of the environment, social and governance concerns fosters long-term business success for the companies we hold shares in our investment programs. Excellent and sustainable investment returns are essential for the long-term financial support of the Sisters of Mercy and their many sponsored schools, colleges, and health care and social service agencies.

We believe that the current rules and thresholds under Rule 14a-8 work well for investors and issuers and should be maintained. Under Rule 14a-8, a company is required to include shareholder proposals from eligible shareholders in its proxy materials unless the proposals do not meet the eligibility and procedural requirements of the Rule or are subject to exclusion for reasons described in the Rule. Shareholders who rely on the Rule may submit only one proposal per corporate annual meeting and are required to have continuously owned at least $2,000 in market value, or 1%, of an issuer's outstanding voting securities for a year or more by the date the proposal is submitted.

Currently, there are a number of bases upon which a company may rely to exclude shareholder proposals, including the provision of the Rule that governs the resubmission of such proposals. Pursuant to this provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the proposal may be excluded for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third.[1]

[1] 17 C.F.R. § 240.14a-8(i)(12).

2039 North Geyer Road · St. Louis, Missouri 63131-3332 · 314.909.4609 · 314.909.4694 (fax)
www.mercyinvestmentservices.org

Critics of the benefits of shareholder proposals and the way Rule 14a-8 has effectively governed the proposal process express various arguments purporting to justify unnecessary reforms and prohibitive requirements, which we address in the following sections. Their proposed new requirements would restrict shareholders' ability to put forth and vote on important proposals; however, these arguments do not withstand scrutiny:

Shareholder Proposals Should Remain Open to Investors of All Sizes

Some critics argue that the SEC makes it too easy for shareholders to submit a proposal. Currently, a shareholder owning $2,000 worth of a company's shares for at least one year is permitted to submit a shareholder proposal. While at one time, ownership of a single share of stock came with the right to submit a proposal; in 1983 the SEC decided it made sense to have a modest but still low requirement, setting the threshold at $1,000 held for at least one year. The SEC in 1998 raised this to $2,000, "to adjust for the effects of inflation," but did not raise it further "in light of rule 14a-8's goal of providing an avenue of communication for small investors." Such a requirement helps to ensure that smaller, 'Main Street' investors have the same rights to file a proposal as wealthier individuals and institutional investors. As such, the filing threshold ensures a form of shareholder democracy that is open to nearly all investors, as it should be.

Shareholder Proposals Cannot Currently be Re-submitted Too Easily

Critics of Rule 14a-8 suggest that resubmission thresholds should be raised to reduce the number of proposals filed repeatedly for a number of years. The data, however, do not support that re-filings are a problem. According to Institutional Shareholder Services ("ISS") data, from 2010 to 2017, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years. This affected only 26 companies.[2] In other words, resubmission of proposals receiving less than 20% support for a third or fourth time is very rare.

Experience also indicates that it often takes several years for a proposal regarding an emerging issue to gain enough traction with investors to achieve double-digit votes. In many cases, these proposals eventually receive substantial support, leading to widespread adoption by companies. For example, in 1987 an average of 16% of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81% level of support on average. Ten years ago, fewer than 40% of S&P 500 companies held annual director elections compared to more than 66% of these companies today.[3] The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

Shareholder Proposals are Not Abused by Activist Investors

Abuse of the proposal process by alleged activist investors is another misguided argument used in favor of restricting shareholders' rights. According to this allegation, a small number of activist investors abuse the system by accounting for a disproportionate volume of proposals. While the ISS database does show that the Chevedden, Steiner, and McRitchie families submitted 14.5% of the 11,706 proposals filed between 2004 and 2017, *the average vote on these proposals was 40%*.[4] This average vote level indicates that these filers provide a valuable service to fellow shareholders by promoting good corporate governance.

[2] ISS Voting Analytics database.
[3] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013
[4] ISS Voting Analytics database.

For example, these investors frequently focus on encouraging companies to adopt best-practice corporate governance reforms such as eliminating supermajority voting requirements, appointing an independent board chair, eliminating staggered boards, and giving shareholders a "say on pay" and "proxy access" to nominate candidates for board elections.[5]

Shareholder Proposals Are Not the Cause of the Reduction in Public Traded Companies

Only a small proportion of proposals are filed at companies with a recent IPO -- less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.[6] Because large companies make up a larger portion of investors' equity portfolios than small companies, larger companies are more likely to receive shareholder proposals.

There are numerous factors contributing to the reduction in the number of public companies in the U.S. According to Vanguard, these include:[7]

- A steep drop in the number of small and micro-firm IPOs compared with the number of IPOs during the tech bubble in the late 1990s. Vanguard explains: "It appears that companies are choosing to be acquired by larger public companies rather than go public themselves."
- In 2016, more than 4,800 private companies were acquired, compared with about 1,950 during the IPO peak in 1996.[8]
- Mergers are also the leading cause (and a generally growing proportion) of delistings.
- Overall, Vanguard concludes that "the shrinking number of publicly listed companies consists almost entirely of those [micro] securities that would not have been invested in by active and passive funds anyway."
- Vanguard also points out that growth in private equity is outpacing growth in public equity. Contributing to the growth in private funding of companies is a series of regulatory changes. The 1996 Securities Markets Improvement Act made it easier for private companies to sell stock to "qualified purchasers," meaning institutional investors and wealthy individuals.[9] The SEC also adopted rules to encourage "private placements," allowing private firms to raise millions of dollars while avoiding public reporting.[10]

Due to these factors, among other macro forces such as low interest rates spurring debt financing,[11] private assets under management grew from less than $1 trillion in 2000 to more than $5 trillion last year. As a result, many companies no longer need an IPO to raise capital.[12]

These changes in market structure, and the deregulation of private investments, are far more important than shareholder proposals in reducing the number of public companies and offerings. In fact, there is no evidence that shareholder proposals are a factor in reducing IPOs, or in increasing the number of mergers, or companies going private.[13]

---

[5] https://www.lexology.com/library/detail.aspx?g=b6ad9d24-4a68-4736-8b28-3bbbadfbd7f5

[6] ISS Voting Analytics database, and https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf

[7] https://personal.vanguard.com/pdf/ISGPCA.pdf

[8] https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital- markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf

[9] https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/

[10] Ibid.

[11] Ibid.

[12] Ibid.

[13] https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf, p. 10

Shareholder Proposals Do Not Meaningfully Increase Costs

Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS database.[14] In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a shareholder proposal, the median number of proposals is one per year.

Importantly, the cost to companies of the existing shareholder proposal process is generally low (and something companies have control over managing),[15] and the process often results in benefits to companies. As noted, most companies receive few, if any, shareholder proposals. In 2016, there were fewer than 1,000 total shareholder proposals filed at all reporting companies in the U.S.[16] Only half of the proposals submitted by shareholders appear in companies' proxies and, consequently, relatively few companies (fewer than 500 in 2016) held votes on issues submitted by shareholders.[17] This is in part due to meaningful dialogues that happen between investors and management that leads to win/win agreements - resulting in the withdrawal of resolutions. In any given year, one quarter to one third of resolutions on environmental and social issues, for example, are withdrawn because of such agreements. And some governance issues like majority vote for directors and access to the proxy result in even higher rates of agreement, making a vote unnecessary.

Finally, the SEC oversees a robust "no-action letter" process that allows companies to exclude proposals from the proxy ballot that do not meet specific procedural or substantive hurdles.

Investors Benefit from the Valuable Services Proxy Advisors Provide to Advance Good Corporate Governance

Some argue that investors over-rely on proxy advisors ISS and Glass Lewis who account for 97% of market share in the industry. The alleged result is that ISS and Glass Lewis functionally control substantial voting shares of thousands of companies in their portfolios, and that this control empowers them to set standards for corporate governance by choosing which shareholder proposals to support. While many institutional investors do rely on proxy advisors for advice and administrative help, voting decisions remain the ultimate responsibility of investors. As the Council of Institutional Investors (CII) states in their letter to the House Committee on Financial Services, dated November 9, 2017:

> *"Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons."*

In fact, Mercy Investment Services has implemented a set of proxy voting guidelines that assure that the proxy votes made by our proxy advisor are consistent with our voting preferences and guidelines.

Proxy Advisors Decrease Costs for Investors

Reliance on proxy advisers provides cost savings and market externality benefits to investors. Large, widely diversified institutional investors must manage proxy voting related to up to 38,000 annual

---

[14] Ibid.

[15] The Dangerous "Promise of Market Reform": No Shareholder Proposals, Harvard Law School Forum on Corporate Governance and Financial Regulation, Adam Kanzer, 2017

[16] ISS Voting Analytics database

[17] Ibid.

meetings globally each year according to CII. Clearly, it is more efficient for most investors to rely on assistance from proxy advisors who can spread some of the costs of voting across thousands of clients than for each institutional investor to try to manage this herculean ask on their own.

Corporate Managers Benefit from Investor Input on Environmental, Social, and Governance Issues

One complaint argues that the shareholder proposal process is redundant because company management already considers environmental, social and governance (ESG) issues. However, if management already addresses a particular ESG issue set forth by the proposal, investors are far less likely to waste time filing the proposal in the first place, and the proposal can be challenged and rejected as "substantially implemented." A second complaint concerns an alleged lack of connection between ESG issues and shareholder value. For example, investors such as BlackRock, State Street and more than 1,700 members of the Principles for Responsible Investment have all publicly proclaimed the importance of ESG issues to shareholder value.[18] These claims are backed by a robust set of academic research.[19] [20] In fact, more than 20% of assets under management in U.S. markets are managed with some form of ESG strategy according to US SIF.[21] Clearly, ESG issues are frequently financially material.

Conclusion

Mercy Investment Services does not believe revisions of Rule 14a-8 are necessary at this time. The existing Rule currently allows institutional investors of all sizes, and individual shareholders alike, who are long term investors in these companies, to engage corporate boards and senior management to address important environmental, social, and governance issues and long-term risk management that can have a direct financial impact on their investments, which in many cases are used to provide financial support during retirement and for important social services such as schools, health care and social services. Shareholder proposals frequently address emerging systemic risks to the U.S. and globally economies, such as the predatory lending that contributed to the 2008 financial crisis.

The current process also allows investors to communicate with boards, management, and other shareholders about the most effective, proactive way to protect investor interests with respect to corporate governance, risk, and policy issues affecting companies prior to a crisis. As such, the existing process serves an important self-regulatory function for U.S. capital markets, allowing shareholders a means to protect their interests through a form of shareholder democracy. Additional government interference in this private ordering process is not necessary or advisable.

For these reasons, we oppose further restricting shareholder proposals, which are helpful to companies, investors, and the economy as whole. Thank you for considering these views. We welcome the opportunity to work with you to address these concerns.

Sincerely,

Susan S. Makos

Susan Smith Makos
Vice President of Social Responsibility

[18] https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment
[19] https://responsiblebusiness.haas.berkeley.edu/research/moskowitz-past-winners.html
[20] https://www.ussif.org/performance
[21] https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf

Ohio Public Employees Retirement System

OPERS

December 6, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20515

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20515

Re: December 6, 2018, hearing entitled "Proxy Process and Rules: Examining Current Practices and Potential Changes"

Dear Chairman Crapo and Ranking Member Brown:

We are writing on behalf of the Ohio Public Employees Retirement System (OPERS) to provide an institutional investor's perspective on the role and regulation of proxy advisory firms within the proxy process. We would also respectfully request that this letter be included in the hearing record.

OPERS is the largest public retirement system in Ohio, with more than one million active, inactive, and retired members. Almost one out of every 12 Ohioans has some connection to our System. In order to provide secure retirement benefits for our members, OPERS invests more than $100 billion in capital markets around the world, including holdings in more than 9,300 public companies. As a fiduciary, OPERS is required to act in the best interest of its members, and this responsibility extends to the prudent management of the investments we make with our members' retirement contributions. More than two-thirds of OPERS' annual benefit payments are funded through investment returns. As a result, OPERS is focused on maximizing wealth across its investment portfolio.

We firmly believe that wealth maximization and positive shareholder engagement go hand-in-hand. In fact, we consider effective engagement to be a key component of our fiduciary duty to our members. As such, OPERS regularly engages with public companies in order to establish a dialogue with boards of directors and management. Through this engagement, our goal is to better understand the viewpoints of the public companies in which we are invested, and to more effectively convey our thoughts and concerns regarding the maximization of shareholder wealth.

Effective engagement requires that we are aware of, and able to address the many governance issues that can arise in any given year. However, with limited staff and resources, it is extremely difficult to devote the necessary time and attention to the thousands of proxies we receive each proxy season. Consequently, OPERS has chosen to partner with a proxy advisory firm, which allows us to fulfill our engagement and governance obligations in a more productive and efficient manner.

OPERS Utilizes the Services Provided by its Proxy Advisory Firm to Improve the Efficiency and Effectiveness of its Shareholder Engagement

Like many institutional investors, OPERS has developed its own corporate governance policy and proxy voting guidelines to govern our voting decisions and ensure that we are maintaining an appropriate balance between maximizing shareholder wealth and upholding our principles and values as a trusted public institution.

OPERS receives in excess of 10,000 proxies in any given proxy season. We have determined it is more operationally efficient to use the workflow of our proxy advisory firm to cast votes on these matters. However, as part of our contractual relationship with our proxy advisory firm, we have insisted that our corporate governance policy and proxy voting guidelines be integrated with their voting platform, so that all votes made on OPERS' behalf are made in accordance with *our* policies and guidelines, as opposed to the proxy advisory firm's recommendations. In this way, OPERS maintains complete control over its proxy votes, though in most cases they are being cast by the proxy advisory firm. There is no instance where OPERS defers to its proxy advisory firm's voting recommendations (i.e., "robo-voting") or otherwise abdicates its responsibility regarding governance decisions. In fact, there are many instances where we choose to manually review proposals based on our corporate governance program's focus areas.

In practice, we have observed that there is a significant percentage of votes cast with management (79.5%). Year to date, OPERS' proxy votes have tracked those of its proxy advisory firm 86.1% of the time, a mere 6.6% difference from alignment with management recommendations.

In addition to the customized proxy advisory firm voting platform, OPERS also depends heavily on the research reports we receive from our proxy advisory firm. These reports are critical to the internal analyses we perform before any vote is submitted. Without access to the timely and independent research provided by our proxy advisory firm, it would be virtually impossible to meet our obligations to our members.

OPERS is Satisfied that its Proxy Advisory Firm Adequately Discloses Conflicts of Interest and is Responsive to Concerns Regarding Errors in Research Reports

Among the many criticisms leveled at the two largest proxy advisory firms is the concern that a proxy advisor's ownership structure or ancillary services can create significant conflicts of interest that are not currently disclosed or addressed in an appropriate manner. However, this line of thought is based on the premise that investors generally defer to proxy advisory firm recommendations, providing these firms with immense influence that can be used to develop business or curry favor with certain clients or groups.

As described above, OPERS has not ceded any decision-making authority to its proxy advisory firm. Rather, each of our proxy votes is made in accordance with our corporate governance policy and proxy voting guidelines, which are reviewed at least annually and approved by our Board of Trustees. More than that, as responsible investors, we are interested in our partners' business practices and operational controls, and we need to know if there is a specific conflict of interest that could impact the independence of the research we receive from our proxy advisory firm. But that information is already listed prominently on the first page and in the appendix of the research reports provided to each client. OPERS currently has access to the information it needs to make informed decisions regarding the nature of its proxy advisor's conflicts and business interactions.

OPERS is also aware of criticisms regarding the accuracy and validity of proxy advisory firm research reports. As an active and engaged investor, we have an interest in ensuring that we are receiving complete and accurate information from our proxy advisory firm. But we do not simply rely on unverified research reports. We have controls in place to identify and mitigate proxy advisory firm errors, including a comprehensive annual review of our custom vote policy and an individual review of ballots containing manual vote items.

As a result of our own internal research, we have, on very few occasions, identified errors in the research reports we receive from our proxy advisory firm. In one example, the research report listed an incorrect name for a director candidate, and was quickly addressed following communication from OPERS. On another occasion, we had questions regarding the correct application of our proxy voting rules, which was also addressed to our satisfaction. In both cases, our proxy advisory firm was responsive and acted immediately to rectify the problem. While these few experiences underscore the importance of engagement and internal review on the part of the investor, we continue to be satisfied with the quality and independence of the research we receive from our proxy advisory firm.

<u>OPERS Does Not Believe Additional Regulation of Proxy Advisory Firms is Necessary or Beneficial</u>

OPERS has contracted with its proxy advisory firm in an effort to better engage with the companies in which it has invested. This contractual relationship helps us to fulfill our fiduciary responsibility to our members. While we do not believe the relationship between proxy advisory firms and their clients should be further regulated, if the Committee is convinced that additional regulation is necessary, we would respectfully request that it considers the potential impact of any such action on the public employees who depend on us to invest their contributions in an effective and cost-efficient manner.

As the Committee contemplates whether and how to address concerns regarding proxy advisory firms, it is instructive to consider recent legislative efforts to regulate proxy advisory firms and their impact on the contractual relationships between proxy advisors and their clients. For example, the Corporate Governance Reform and Transparency Act of 2017 (H.R. 4015), which passed the U.S. House of Representatives last December, would mandate that proxy advisory firms make significant changes to their business models in an effort to foster "accountability, transparency, responsiveness, and competition in the proxy advisory firm industry."[1] Specifically, the bill requires, among other things, that proxy advisory firms hire an ombudsman to receive and address issuer concerns, and offer issuers the opportunity to preview and provide recommendations on research reports.[2] In so doing, the legislation would increase the time and cost of receiving proxy advisory firm research reports, while also

[1] Corporate Governance Reform and Transparency Act of 2017, H.R. 4015, 115th Congress (2017).
[2] *See id.*, Section 15H(g).

increasing the likelihood that the final research reports would be less independent and more unreliable for the investors that depend on them. Issuer concerns regarding proxy advisory firm methodologies and decision-making processes notwithstanding, OPERS must be able to rely on the independence and objectivity of the information it receives from its proxy advisory firm. For these reasons, OPERS opposes H.R. 4015, and would respectfully request that the Committee avoid taking similar actions that would increase our costs, compress the timelines for receiving research reports, or diminish the independence of the research we receive from our proxy advisory firm.

Conclusion

Proxy advisory firms provide a necessary and valuable service to investors that wish to fully participate in the governance process and more effectively engage as shareholders. The relationship we have with our proxy advisory firm has allowed us to fulfill our fiduciary duty in a more efficient manner. The administrative costs of attempting to recreate or duplicate the research we receive from our proxy advisory firm would be prohibitive for a public institution like OPERS.

As described above, OPERS does not believe additional regulation of proxy advisory firms is warranted. If however, the Committee believes that some intervention is necessary, we urge you to carefully consider the consequences of any potential changes, particularly for the investors that depend on the information provided by proxy advisory firms. To the extent that a legislative change increases our costs, delays the information we need, or erodes the confidence we have in the independence of the research reports we receive, there will be a negative impact on our members – the law enforcement officers, university employees, librarians, road workers, and others who depend on us for their retirement security. We respectfully request that the Committee preserve our access to efficient, timely, and independent information from our proxy advisory firm.

If you have questions regarding OPERS' comments, please do not hesitate to contact OPERS' Corporate Governance Officer, Patti Brammer, at 614.225.0942.

Sincerely,

Karen E Carraher

Karen Carraher
Executive Director

Patti Brammer

Patti Brammer
Corporate Governance Officer

Priests of the Sacred Heart

Provincialate Offices, United States Province.
7373 S. Highway 100, P.O. Box 289
Hales Corners, Wisconsin 53130-0289

General Phone: 414-425-6910
Fax: 414-425-2938

December 7, 2018

The Honorable Michael Crapo, Chair,
Committee on Banking, Housing & Urban Affairs
Washington, D.C.

Re: File 4-725--Staff Roundtable on the Proxy Process

Dear Senator Crapo,

The Priests of the Sacred Heart, a U.S. Catholic religious congregation based in Wisconsin, wish to affirm the current shareholder proposal process as effective, efficient and beneficial to both shareholders and the long-term well-being of the companies they hold.

Our congregation has approximately 84 priests and brothers working in numerous ministries in Wisconsin, Mississippi, Texas and South Dakota, and has $240 million AUM.

We have been members since 2014 of Seventh Generation Interfaith Coalition for Responsible Investment (SGI), a regional affiliate of the Interfaith Center on Corporate Responsibility (ICCR). ICCR has already submitted their comment on this matter, and we fully support their letter.

We agree with ICCR that there is no need to revise the rules governing the proxy process, which has served for decades as a cost effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own.

Because of shareholder engagements and resolutions brought by ICCR members, SGI members, and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.

We are especially concerned about any changes to the following:

Ownership Threshold: We believe that the current ownership threshold of $2,000 allows an important diversity of investors to be heard, and that raising the threshold will exclude smaller investors from participating in the proposal process and raise concerns about the equality of the system. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution.

Resubmission thresholds: We believe the current thresholds provide a framework that has served the process well. The rising thresholds in the first, second and third year provide a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward. Claims of abuses or that shareholder resolutions are a burden on the markets are not supported by the evidence.

Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even receive a shareholder resolution. According to ISS Voting Analytics, the average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year. Often resolutions are withdrawn by proponents after they prompt a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes that can transform businesses.

Many of the companies that ICCR members engage recognize the value that engagement with shareholders brings. Increasing re-submission thresholds would likely inhibit important contributions to corporate governance that have proven to be beneficial to the long term health and performance of companies.

There are many examples of shareholder resolutions that initially received little support but through investor education were eventually recognized as the important issues and risks to companies that they were. Issues originally brought to the attention of corporate boards and fellow shareholders through proposals resulted in companies adopting suggested practices, many of which are now seen as best practice.

Influence of proxy advisory firms: Critics' claims that these firms have excessive influence do not bear scrutiny. While institutional investors like ourselves do look to proxy advisory firms to provide research and guidance to help inform our decisions, the ultimate decision remains ours. The real motivation behind the special interests opposed to the proxy advisory firms is to undermine the in-depth analysis that they provide and encourage investors to simply vote in alignment with how corporate boards and management see fit, regardless of fiduciary duty or interest in long-term shareholder value.

The claim that resolution sponsors motives are "political" and that they have no interest in creating shareholder value is untrue, and betrays the political agenda of their critics, which is to limit the ability of shareholders to engage with the companies that they own, and to cripple the proxy process that has been in place for over fifty years.

The Priests of the Sacred Heart are long-term investors who are deeply concerned about the returns on and growth of the investments in our portfolios. We and other members of SGI press companies on environmental, social, and governance risks precisely because we are concerned with the long-term health of the companies in which we are invested.

In conclusion, the Priests of the Sacred Heart strongly believe that the filing of resolutions is a fundamental tenet of shareholder democracy that should be protected. We appreciate this opportunity to provide input. Please call me at 414-427-4273 with any questions.

Sincerely,

Mark Peters

Mark Peters, Director of Justice, Peace and Reconciliation, US Province

INTERFAITH CENTER ON CORPORATE RESPONSIBILITY
Inspired by faith. Committed to action

December 4, 2018

The Honorable Michael Crapo
Chair
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

RE: Hearing on Proxy Process and Rules, December 6, 2018

Dear Chair Crapo and Ranking Member Brown,

In anticipation of the hearing scheduled for December 6th on the "Proxy Process and Rules: Examining Current Practices and Potential Changes," we would like to submit our viewpoint as investors concerned about the shareholder proposal process. The Interfaith Center on Corporate Responsibility (ICCR) is a coalition of more than 300 institutional investors collectively representing over $400 billion in invested capital. Our members are composed of a cross section of religious investors, foundations, asset managers, pension funds, and other long-term institutional investors. Members of ICCR have been involved in the shareholder resolution process since 1971, giving us over 45 years of experience in shareowner engagement and the proxy process.

We believe the current shareholder proposal process is effective, efficient and beneficial to both shareholders and the long term well-being of the companies. We firmly believe that there is no need to revise the rules governing the proxy process. For decades, the shareholder proposal process has served as a cost effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own. This efficient system of private ordering has led to the widespread adoption of a number of constructive corporate governance practices that have become standard in the field, such as independent directors, declassifying boards, "say on pay" vote requirements, and many others. The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of productive engagement with shareowners, including the filing of resolutions.

Several issues have recently been highlighted as of concern to the shareholder community that we would like to specifically address: ownership thresholds, resubmission thresholds, representation of long term retail investors, the cost of proposals to companies, and the influence of proxy advisory firms.

475 Riverside Drive, Suite 1842, New York, NY 10115 (212) 870-2295
www.iccr.org

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard including smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

The issue of resubmission thresholds is also raised as a topic for discussion. We believe the current thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even see a shareholder resolution. It is also worth noting that often resolutions are withdrawn by their proponent after prompting a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes that can transform businesses. ICCR member experience has shown that approximately one third of resolutions filed result in dialogue and agreements, with resolutions being withdrawn from the proxy.

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks presented to companies that they produced. The issue of declassified boards is just one example – in 1987 proposals on this issue received under 10% support; in 2012 - 81%, and it is now considered best practice.

There are numerous additional examples, including:

Resolutions with oil and gas majors beginning in 1998 requesting reporting on the risks of climate change. In the early years, these resolutions often received below 5% of shareholder support. The 2017 proxy season saw a resolution requesting a business plan in alignment with the 2° C warming threshold established in the Paris Climate Agreement achieve a 67% vote at Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources.
Resolutions highlighting human rights risks in corporate operations and global supply chains have brought human trafficking and forced labor to the forefront. As a result of proxy pressure, sector leaders such as Coca Cola, HP, Ford and Gap now have human rights policies and supplier

codes of conduct that help them uncover and eradicate these violations from their supply chains - along with the legal, reputational and financial risks they represent.

Proposals like these and many others could be excluded in increasing re-submission thresholds, potentially inhibiting important contributions to corporate governance that have proven to be beneficial to the long term health and performance of companies.
The influence of proxy advisory firms was also raised as a potential topic for review. Critics have posited misperceptions about these firms; including that they have excessive influence. While institutional investors do look to proxy advisory firms to provide research and guidance to help inform their decisions, the ultimate decision remains in the hands of the investor. There is no obligation to follow the recommendations of the proxy advisors, and there are plenty of examples in which investors vote counter to the recommendations. The real motivation behind the special interests opposed to the proxy advisory firms is to undermine the in-depth analysis that they provide and encourage investors to simply vote in alignment with how corporate boards and management see fit, regardless of fiduciary duty or interest in long-term shareholder value.

Critics of the shareholder resolution process including major trade organizations like the Business Roundtable, the National Association of Manufacturers, and the U.S. Chamber of Commerce use over-the-top rhetoric to try and discredit resolution sponsors, arguing that their motives are "political" and that they have no interest in creating shareholder value. These industry critics have a clear political agenda of their own – to limit the ability of shareholders to engage with the companies that they own, and to cripple the proxy process that has been in place for over fifty years. The long-term investors who are members of ICCR are deeply concerned about the returns on and growth of the investments in their portfolios. Our members press companies on environmental, social, and governance risks precisely <u>because</u> they are concerned with the long-term health of the companies in which they are invested. Many of the companies that we engage with see the great value that this engagement brings, for example, by enabling companies to identify and address reputational and legal risks in advance, before they become liabilities for the company.

For further consideration, attached is a white paper drafted by Ceres, along with ICCR and The Forum for Sustainable and Responsible Investment (US SIF) entitled, <u>"The Business Case for the Current SEC Shareholder Proposal Process."</u> This paper provides an investor perspective on the value to both companies and investors of the shareholder proposal process as currently outlined under SEC Rule 14a-8.

In conclusion, we reiterate ICCR's support of the shareholder proposal process as it is currently practiced under Rule 14a-8 and believe altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected.

We appreciate this opportunity to provide input. Please feel free to contact me with any questions.

Sincerely,

Josh Zinner
CEO
Interfaith Center on Corporate Responsibility
jzinner@iccr.org

VERT
ASSET MANAGEMENT

Via electronic delivery

December 6, 2018

The Honorable Michael Crapo
Chair
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

RE: Hearing on Proxy Process and Rules, December 6, 2018

Dear Chair Crapo and Ranking Member Brown,

On behalf of Vert Asset Management, I respectfully submit the following comments in response to the Hearing on Proxy Process and Rules on December 6, 2018. Our comments focus on keeping proxy advisory firms independent and the important guidance they give to investors.

Vert Asset Management (Vert) is a dedicated ESG fund manager. We work in close consultation with academic experts and experienced portfolio managers to create investment products that work for the wealth management community. Vert combines ESG research and a disciplined rules-based process to deliver funds that achieve investors' twin goals of sustainability and market rates of return.

As a manager of a mutual fund, we are required to vote all our proxies each year. We use the services of proxy advisory firms in conjunction with our sub-advisor's own internal corporate governance policy to inform our proxy votes. It should be clear that the proxy advisory role is to serve the investors. It is important that proxy advisory services remain independent in their recommendations and are not revised by a company that may not agree with or like their recommendations. We posit that if there are factual errors in the proxy advisor's research these should be corrected in a timely manner so that the recommendation reflects the correct information. Proxy advisors will need to maintain high levels of accuracy to continue to earn our and other investors' business, especially given the growing demand of investors concerned with board and corporate governance issues. We believe market forces are sufficient. There is no role for company review in what is an independent research process.

Thank you for taking our ESG investment management perspective into consideration. We appreciate the opportunity to submit this statement.

Sincerely,

Sarah Adams
Chief Sustainability Officer
Vert Asset Management

Sisters of the Holy Names of Jesus and Mary
U.S.-Ontario

Dec. 6, 2018

The Hon. Michael Crapo, Chair
Committee on Banking, Housing & Urban Affairs

Dear Senator Crapo,

The Sisters of the Holy Names of Jesus and Mary, U.S.-Ontario Province have long been members of the Interfaith Center on Corporate Responsibility (ICCR), which has been involved for decades in the shareholder resolution process. We Sisters are dismayed by the proposal to revise the rules governing the proxy process.

Value of shareholder engagement

- The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions. The process has served as an invaluable tool to both shareholders and companies to bring to light emerging risks and to facilitate their mitigation before they result in negative consequences.
- Because of shareholder engagements and resolutions brought by ICCR members, including the Sisters of the Holy Names and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.
- Many of the companies that ICCR members engage recognize the value that engagement with shareholders brings.

Ownership Thresholds (minimum value of shares owned in order to file a shareholder proposal)

- The current ownership threshold of $2,000 allows an important diversity of investors to be heard
- Raising the threshold excludes smaller investors like the Sisters of the Holy Names from participating in the proposal process.
- Time frame of holding shares for a year ensures that investors are concerned about the long term value of the company. There is no need to change it.

PO Box 398, Marylhurst, OR 97036 · 503-675-7100 · info@snjmuson.org · snjmusontario.org

Resubmission Thresholds (question of whether to increase the minimum votes a proposal receives from all shareholders in order to re-submit a proposal)

- Current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward.
- There are many examples in ICCR's history of issues that initially received little support but through investor education were eventually recognized as the important issues and risks to companies that they were. Issues originally brought to the attention of corporate boards and fellow shareholders through proposals resulted in companies adopting suggested practices, many of which are now seen as best practices.
- Important areas where progress has been made include: climate change, human rights risks assessments, financial practices, governance standards.

Trade associations such as Business Roundtable, U.S. Chamber of Commerce and National Association of Manufacturers are creating a false impression that resolutions are a major burden on companies. However, the vast majority of companies never even receive a shareholder resolution. For those that do, it is notable that oftentimes resolutions end up being withdrawn by the proponent because of conversations between them and the company. Many times this leads to changes beneficial to the company.

The average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year (ISS Voting Analytics).

In conclusion, for the financial health of our country and for our democracy, we believe it is unconscionable to raise the minimum value of shares owned in order to file a shareholder proposal. Also, increasing the minimum votes a proposal receives from all shareholders in order to re-submit a proposal would undermine the ability of shareholders to advance resolutions that lead to beneficial changes.

We sincerely hope that you will **not** support the proposed changes for the Proxy Process and Rules.

Sincerely,

Mary Breiding, snjm Maureen Delaney, SNJM
Guadalupe Guajardo, snjm Margaret Kennedy, snjm Mary Rita Rohde, snjm

Provincial Leadership Team
Sisters of the Holy Names of Jesus and Mary, U.S.-Ontario Province

Dominican Sisters of Springfield Illinois
Sacred Heart Convent
1237 West Monroe Street
Springfield, Illinois 62704
(217) 787-0481 Fax (217) 787-8169

December 3, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs.

SUBJECT: **SHAREHOLDER RIGHTS**

As a member of Interfaith Center on Corporate Responsibility (ICCR) and a faith-based investor, we **strongly support ICCR's positions on the protection of our shareholder rights.**
The Dominican Sisters of Springfield, IL believe that socially responsible investments do not deal only with risks and return, but also with the ethical standards of companies. The values and principles of Catholic social teaching, in particular those regarding human dignity, the common good, preferential option for the poor, and responsible stewardship of resources, together with the desire to witness to the development of a world order based on justice and peace, provide the basis our investment approach.
As investors we value the **right to have shareholder engagements** with companies.

- Members of ICCR have been involved in the shareholder resolution process since 1971, giving us over 45 years of experience in shareowner engagement and the proxy process.
- The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions. The process has served as an invaluable tool to both shareholders and companies to bring to light emerging risks and facilitate the mitigation before they result in negative consequences.
- Because of shareholder engagements and resolutions brought by ICCR members and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.
- Many of the companies that ICCR members engage recognize the value that engagement with shareholders brings.

Ownership Thresholds (minimum value of shares owned in order to file a shareholder proposal)

- The current ownership threshold of $2,000 allows an important diversity of investors to be heard.

Dominican Sisters of Springfield Illinois
Sacred Heart Convent
1237 West Monroe Street
Springfield, Illinois 62704
(217) 787-0481 Fax (217) 787-8169

- Raising the threshold excludes smaller investors from participating in the proposal process.
- Time frame of holding shares for a year ensures that investors are concerned about the long term value of the company, there is no need to change it.

Resubmission Thresholds (question of whether to increase the minimum votes a proposal receives from all shareholders in order to re-submit a proposal)

- Current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward.
- There are many examples in ICCR's history of issues that initially received little support but through investor education were eventually recognized as the important issues and risks to companies that they were. Issues originally brought to the attention of corporate boards and fellow shareholders through proposals resulted in companies adopting suggested practices, many of which are now seen as best practice.
- Important areas where progress has been made include: climate change, human rights risks assessments, financial practices, governance standards

Other

- Trade associations such as Business Roundtable, U.S. Chamber of Commerce, and National Association of Manufacturers are creating a false sense that resolutions are a major burden on companies. However, the vast majority of companies never even receive a shareholder resolution. For those that do, it is notable that often times resolutions end up being withdrawn by the proponent because of conversations between them and the company. Many times this leads to changes beneficial to the company.
- The average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year (ISS Voting Analytics)

Respectfully submitted,

Sister Marcelline Koch, O.P.

Sr. Marcelline Koch, O.P.

Presbyterian Church (U.S.A.)
Presbyterian Mission
100 Witherspoon Street | Louisville, KY 40202 | presbyterianmission.org

December 4, 2018

The Honorable Michael Crapo and The Honorable Sherrod Brown
Chair and Ranking Member
United States Senate Committee on Banking, Housing & Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Comments for the United States Senate Committee on Banking, Housing & Urban Affairs Securities and Exchange Commission (SEC) Hearing on December 6, 2018 on Proxy Process and Rules: Examining Current Practices and Potential Changes

Dear Senators Crapo and Brown:

The Presbyterian Church U.S.A. (PCUSA) is a major Protestant denomination with nearly 1.6 million members. The PCUSA represents $11 billion in assets through its Board of Pensions and Foundation/New Covenant Trust Company. These investing agencies of the church are fiduciaries that respectively steward the pension plans for clergy as well as fund the mission of the church. Since 1971, these agencies have operated under responsible investing policies set by the church's General Assembly. For nearly five decades, the Committee on Mission Responsibility Through Investment (MRTI) of the PCUSA, has worked to implement those policies through engagement of the publicly traded corporations held by the church's investing agencies.

As a founding member of the Interfaith Center on Corporate Responsibility (ICCR) the PCUSA, through the Committee on MRTI would like to write in support of the November 6, 2018 letter to SEC Chairman Clayton from Josh Zinner, CEO, of the ICCR. The Committee on MRTI of the PCUSA is in full support of the shareholder proposal process as it is currently practiced under SEC Rule 14a-8. Please feel free to contact me if you have any questions.

Sincerely,

Rob Fohr
Director of Faith-Based Investing and Corporate Engagement
Presbyterian Church U.S.A.
502.569.5035
rob.fohr@pcusa.org

Presbyterian Church (U.S.A.)
Presbyterian Mission

100 Witherspoon Street | Louisville, KY 40202 | presbyterianmission.org

cc: Joseph Kinard, Chair, Committee on Mission Responsibility Through Investment of the Presbyterian Church U.S.A.

enc: November 6th Letter from Josh Zinner (CEO, ICCR) to Chairman Jay Clayton

Church Investment Group
Serving the Episcopal Church and Its Christian Mission

November 30, 2018

Senate Committee on Banking, Housing & Urban Affairs
The Honorable Michael Crapo, Chair and The Honorable Sherrod Brown, Ranking Member

Re: Review of the Proxy Process

Dear Senators Crapo and Brown:

The Church Investment Group (CIG) supports the existing rules governing the proxy process. The current shareholder proposal process serves as a way for CIG's Episcopal Church endowments to exercise their rights as shareholders, who are the ultimate owners of corporations.

The Church Investment Group is a non-profit which enables Episcopal Church endowments to join together to invest at scale with just under $100 million in assets and to invest in companies which take into consideration the environmental, social and governance factors that will enable forward-looking companies to be profitable in the decades to come.

As members of the Interfaith Center on Corporate Responsibility, we support the comments which ICCR submitted which reviews the issues under consideration at greater length. As ICCR notes, the current proxy process has resulted in constructive improvements in corporate governance, as well as modifications in corporate behavior on environmental and labor concerns which have improved the long- term resilience and profitability of the corporations involved.

We would also note that CIG's endowments control the decisions on voting their proxies. While we use a proxy advisory firm, the recommendations are independently reviewed and considered before moving forward on voting our proxies.

We appreciate the opportunity to note that we find the current process effective in enhancing our shareholder value.

Regards,

JoAnn Hanson

JoAnn Hanson
President
Church Investment Group
jhanson@churchinvestment.org

The Peachtree, 1355 Peachtree St., NE, Suite 1775, Atlanta, GA 30309
T: 845-351-2671 www.churchinvestment.org

Zevin Asset Management, LLC

December 4, 2018

Senate Committee on Banking, Housing & Urban Affairs
The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
534 Dirksen Senate Office Building
Washington, D.C. 20510

RE: STATEMENT FOR THE RECORD – Hearing on Proxy Process and Rules: Examining Current Practices and Potential Changes

Chairman Crapo, Ranking Member Brown, and members of the Committee:

I write today on behalf of Zevin Asset Management, a Boston-based company that invests globally, integrating environmental, social, and governance (ESG) issues into our financial analysis. We manage approximately $500 million on behalf of institutional and individual clients who direct Zevin Asset Management to invest responsibly and utilize their considerable voices as shareholders to spur positive change at public companies. Active ownership in the form of constructive shareholder engagement promotes long-term risk management (in both companies and investment portfolios). It also helps investment managers fulfill our duties as responsible fiduciaries while creating positive environmental, social, and economic impact.

As investors, we rely on the current rules governing the proxy process to conduct active ownership on behalf of our clients. As you know, the Securities and Exchange Commission (SEC) is considering changes that would weaken and undermine those rules. **We insist: there is no need to revise the rules governing the proxy process.** We ask that you preserve the current rules and seek to strengthen avenues for active ownership and shareholder engagement in the future.

For decades, the shareholder proposal process has served as a cost effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own. This efficient system of private ordering has led to the widespread adoption of a number of constructive corporate governance practices that have become standard in the field, such as independent directors, declassifying boards, "say on pay" vote requirements, and many others. As cited by the Interfaith Center on Corporate Responsibility (ICCR), there are literally hundreds of examples of companies changing their policies and practices in light of productive engagement with shareowners.

A recent SEC Roundtable considering current proxy rules reviewed several disruptive and negative proposed changes including changes to ownership thresholds, resubmission thresholds, representation of long-term retail investors, the cost of proposals to companies, and the influence of proxy advisory firms.

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard including smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens

2 Oliver Street, Suite 806 | Boston, MA 02109 | www.zevin.com | (617) 742-6666 | invest@zevin.com

Zevin Asset Management, LLC

to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

The issue of resubmission thresholds is also raised as a topic for discussion. We believe the current thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even receive a shareholder resolution. It is also worth noting that often resolutions are withdrawn by their proponent after prompting a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes that can transform businesses. According to ICCR, approximately one third of resolutions filed result in dialogue and agreements, with resolutions being withdrawn from the proxy.

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks they presented to companies. The issue of declassified boards is just one example – support of shareholder proposals on this issue was regularly below 10% in 1987, but eventually grew to 81% in 2012, and it is now considered best practice.

There are numerous additional examples, including:

- Resolutions with oil and gas majors beginning in 1998 requested reporting on the risks of climate change. In the early years, these resolutions often received below 5% of shareholder support. The 2017 proxy season saw a resolution requesting a business plan in alignment with the 2° C warming threshold established in the Paris Climate Agreement achieve a 67% vote at Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources.

- Resolutions highlighting human rights risks in corporate operations and global supply chains have brought human trafficking and forced labor to the forefront. As a result of proxy pressure, sector leaders such as Coca Cola, HP, Ford and Gap now have human rights policies and supplier codes of conduct that help them uncover and eradicate these violations from their supply chains - along with the legal, reputational and financial risks they represent.

Zevin Asset Management, LLC

Proposals like these and many others could be excluded in increasing re-submission thresholds, potentially inhibiting important contributions to corporate governance that have proven to be beneficial to the long term health and performance of companies.

The influence of proxy advisory firms was also raised as a potential topic for review. Critics have posited misperceptions about these firms, including that they have excessive influence. While institutional investors do look to proxy advisory firms to provide research and guidance to help inform their decisions, the ultimate decision remains in the hands of the investor. There is no obligation to follow the recommendations of the proxy advisors, and there are plenty of examples in which investors vote counter to their recommendations. The real motivation behind the special interests opposed to the proxy advisory firms is to undermine the in-depth analysis that they provide and encourage investors to simply vote in alignment with how corporate boards and management see fit, regardless of fiduciary duty or interest in long-term shareholder value.

Critics of the shareholder resolution process, including major trade organizations like the Business Roundtable, the National Association of Manufacturers, and the U.S. Chamber of Commerce, use over-the-top rhetoric to try and discredit resolution sponsors, arguing that their motives are "political" and that they have no interest in creating shareholder value. These industry critics have a clear political agenda of their own – to limit the ability of shareholders to engage with the companies that they own, and to cripple the proxy process that has been in place for over fifty years. Long-term investors are deeply concerned about the returns on and growth of the investments in their portfolios. Responsible investors like Zevin Asset Management routinely press companies on environmental, social, and governance risks precisely because they are concerned with the long-term health of the companies in which they are invested. Many of the companies that we engage see the great value that this engagement brings, for example, by enabling them to identify and address reputational and legal risks in advance, before they become liabilities.

In conclusion, we reiterate our support for the shareholder proposal process as it is currently practiced under Rule 14a-8. We insist that altering this process risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy and responsible ownership that should be protected.

We appreciate this opportunity to provide input and look forward to providing additional guidance at the Committee's request. Please feel free to contact me with any questions.

Most sincerely,

Pat Miguel Tomaino
Director of Socially Responsible Investing
Zevin Asset Management, LLC

DANA | Investment Advisors
THE WISE CHOICE

Date: December 3, 2018
To: The Honorable Sherrod Brown
Ranking Member, Committee on Banking, Housing & Urban Affairs
Re: File 4-725, Staff Roundtable on the Proxy Process

Dana Investment Advisors is an investment manager with $7.1 billion in assets under management. Our clients include institutions (pension funds, endowments and foundations, hospitals, schools) as well as individual investors. Dana is a member of the Interfaith Center on Corporate Responsibility.

The shareholder resolution process, as currently practiced under Rule 14a-8, serves as an invaluable tool to both shareholders and companies, identifying emerging environmental, social, and governance risks and addressing them before the long-term health of companies is negatively affected.

We believe the current rules governing the proxy process should be preserved.

Thank you,

Ann Roberts

Ann Roberts
ESG Analyst
annr@danainvestment.com

20700 Swenson Drive, Suite 400, Waukesha, WI 53186 • P.O. Box 1067, Brookfield, WI 53008-1067
phone: 262-782-3631 • fax: 262-782-0581 • email: annr@danainvestment.com

FAIRR A COLLER INITIATIVE FARM ANIMAL INVESTMENT RISK & RETURN

December 4, 2018

Senate Banking Committee
The Honorable Michael Crapo, Chair; and
The Honorable Sherrod Brown, Ranking Member, Committee on Banking, Housing & Urban Affairs.

Re: File 4- 725 -- Staff Roundtable on the Proxy Process

Dear Sirs:

The FAIRR Initiative is an investor coalition representing institutional investors with over $10.5 trillion in combined assets. Our members are asset managers, pension funds, and other long-term institutional investors, including the Interfaith Center on Corporate Responsibility (ICCR).

As members of ICCR ourselves, we join ICCR and other long-term investors to express our affirmation of the current shareholder proposal process as effective, efficient and beneficial to both shareholders and the long term well-being of the companies they hold. ICCR and its members have been involved in the shareholder resolution process since 1971, giving them over 45 years of experience in shareowner engagement and the proxy process.

The history of ICCR demonstrates examples of hundreds of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions. The process has served as an invaluable tool to both shareholders and companies to bring to light emerging risks and facilitate the mitigation before they result in negative consequences.

While we do not file resolutions ourselves, resolutions from our investor members have been critical to ensuring that companies manage the operational and reputational risks that pose a threat to the long-term growth of investor portfolios.

We would like to reiterate some additional points:

- The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard including smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

- We believe the current thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

FAIRR A COLLER INITIATIVE FARM ANIMAL INVESTMENT RISK & RETURN

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks presented to companies that they produced. A case in point is the irresponsible use of antibiotics in livestock supply chains, detailed in the paragraphs below.

As you may know, the rising incidence of antibiotic resistance – a significant threat to the global economy – is a consequence of antibiotics misuse in both humans and animals. Most of all antibiotics, including antibiotics important to human health, are routinely administered to prevent sickness in healthy animals living in unsanitary conditions and as growth promoters. In the US, for example, over 60% of the antimicrobials sold are medically important.[1]

The strong association between the overuse of antibiotics in animals and the spread of antibiotic-resistance to humans necessitates a signicant change in corporate practices across livestock supply chains. Investors, including members of FAIRR and ICCR, have been leading engagements with companies to drive antibiotics stewardship practices. Resolutions have an an invaluable tool to increase awareness on this issue among institutional investors and to compel companies to act. Through collective advocacy, engagement and selective resolutions, investors have been successful at changing the practice of some of the largest food companies, including McDonald's, Sanderson Farms, Restaurant Brands International, etc. Without the use of resolutions, such progress would never have been achieved, with consequences that endanger antibiotics efficacy – the very foundation on which modern medicine currently operates.

In conclusion, we reiterate FAIRR's support of the shareholder proposal process as it is currently practiced under Rule 14a-8 and believe altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected.

We appreciate this opportunity to provide input and look forward to providing additional written feedback following the Roundtable. Please feel free to contact me with any questions.

Sincerely,

Aarti Ramachandran
Head of Research and Corporate Engagement
FAIRR Initiative

---

[1] US Food and Drug Administration. 2014 Summary Report on Antimicrobials Sold or Distributed for Use in Food-Producing Animals.

Sisters of St. Dominic

Socially Responsible Investment Committee

5635 Erie Street
Racine, WI 53402-1900
www.racinedominicans.org
(262) 898-4094
(262) 639-9702 (fax)

December 4, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs

Subject: **SHAREHOLDER RGHTS**

As a member of Interfaith Center on Corporate Responsibility (ICCR) and a faith-based investor, the Racine Dominican Sisters **strongly support ICCR's positions on the protection of our shareholder rights.**

We promote social and economic justice through our investments by striving to maintain an awareness of the social impact which is being made by those companies whose securities we have purchased.

As investors we value the **right to have shareholder engagements** with companies.

- Members of ICCR have been involved in the shareholder resolution process since 1971, giving us over 45 years of experience in shareowner engagement and the proxy process.
- The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners including the filing of resolutions. The process has served as an in valuable tool to both shareholders and companies to bring to light emerging risks and facilitate the mitigation before they result in negative consequences.
- Because of shareholder engagements and resolutions brought by ICCR members and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.
- Many of the companies that ICCR members engage recognize the value that engagement with shareholders brings.

Ownership Thresholds (minimum value of shares owned in order to file a shareholder proposal)

- The current ownership threshold of $2,000 allows an important diversity of investors to be heard.
- Raising the threshold excludes smaller investors from participating in the proposal process.
- Time frame of holding shares for a year ensures that investors are concerned about the long term value of the company, there is no need to change it.

Resubmission Thresholds (question of whether to increase the minimum votes a proposal receives from all shareholders in order to re-submit a proposal)

- Current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward.
- There are many examples in ICCR"s history of issues that initially received little support but through investor education were eventually recognized as the important issues and risks to companies that they were. Issues originally brought to the attention of corporate boards and fellow shareholders through proposals resulted in companies adopting suggested practices, many of which are now seen as best practices. Leader companies thus emerge to forge the way of continual innovation.
- Important areas where progress has been made include: climate change, human rights risks assessments, financial practices and governance standards.

Other

- Trace associations such as Business Roundtable, U.S. Chamber of Commerce, and National Association of Manufacturers are creating a false sense that resolutions are a major burden on companies. However, the vast majority of companies never even receive a shareholder resolution. For those that do, it is notable that often times resolutions end up being withdrawn by the proponent because of conversations between them and the company. Many times this leads to changes beneficial to the company.
- The average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year (ISS Voting Analytics)

Respectfully submitted,

Sr. Ruth Schaaf, OP
Racine Dominicans
Socially Responsible Investments Coordinator

Seventh Generation Interfaith
Coalition for Responsible Investment

November 30, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Proxy Process and Rules: Examining Current Practices and Potential Changes

Dear Senators Crapo and Brown,

I understand that you will be conducting a hearing on shareholder proxy process and rules on December 6th. The Seventh Generation Interfaith Coalition for Responsible Investment (SGI) wishes to express our affirmation of the shareholder proposal process as it is currently practiced under Rule 14a-8 as effective, efficient and beneficial to both shareholders and the long term well-being of the companies they hold.

SGI is a coalition of thirty (30) faith and values-driven institutional investors located in the Mid-Western United States who view the management of their investments as a powerful catalyst for social change. Our members are composed of a cross section of religious investors, asset managers, and hospital systems. As members of the Interfaith Center on Corporate Responsibility (ICCR), SGI members have been involved in the shareholder resolution process since 1973, giving us over 45 years of experience in shareowner engagement and the proxy process.

We firmly believe that there is no need to revise the rules governing the proxy process. For decades, the shareholder proposal process has served as a cost effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own. This efficient system of private ordering has led to the widespread adoption of a number of constructive corporate governance practices that have become standard in the field, such as independent directors, declassifying boards, "say on pay" vote requirements, and many others.

We appreciate this opportunity to provide input. Please feel free to contact me with any questions.

Sincerely,

Francis X. Sherman
Francis X. Sherman
Executive Director

1015 North Ninth Street • Milwaukee, Wisconsin 53233 • 414.509.8457

Sisters of the Presentation of the Blessed Virgin Mary

In Joyful Service

December 3, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs.

SUBJECT: **SHAREHOLDER RIGHTS**

As a member of Interfaith Center on Corporate Responsibility (ICCR) and a faith-based investor, we **strongly support ICCR's positions on the protection of our shareholder rights.**

The Sisters of the Presentation of the Blessed Virgin Mary promote social and economic justice through their investments by striving to maintain an awareness of the social impact which is being made by those companies whose securities have been purchased, or that are under consideration.

As investors we value the **right to have shareholder engagements** with companies.

- Members of ICCR have been involved in the shareholder resolution process since 1971, giving us over 45 years of experience in shareowner engagement and the proxy process.
- The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of constructive engagement with shareowners, including the filing of resolutions. The process has served as an invaluable tool to both shareholders and companies to bring to light emerging risks and facilitate the mitigation before they result in negative consequences.
- Because of shareholder engagements and resolutions brought by ICCR members and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.
- Many of the companies that ICCR members engage recognize the value that engagement with shareholders brings.

Ownership Thresholds (minimum value of shares owned in order to file a shareholder proposal)

- The current ownership threshold of $2,000 allows an important diversity of investors to be heard.
- Raising the threshold excludes smaller investors from participating in the proposal process.
- Time frame of holding shares for a year ensures that investors are concerned about the long term value of the company, there is no need to change it.

1500 NORTH 2ND STREET ABERDEEN, SOUTH DAKOTA 57401-1238
PHONE (605) 229-8346 FAX: (605) 229-8563
www.presentationsisters.org

Resubmission Thresholds (question of whether to increase the minimum votes a proposal receives from all shareholders in order to re-submit a proposal)

- Current minimums of 3%, 6% and 10% (in the first, second and third year, respectively) votes have been successful in allowing time for emerging issues to increasingly receive support from investors while still ensuring that proposals that receive meaningful support are moved forward.
- There are many examples in ICCR's history of issues that initially received little support but through investor education were eventually recognized as the important issues and risks to companies that they were. Issues originally brought to the attention of corporate boards and fellow shareholders through proposals resulted in companies adopting suggested practices, many of which are now seen as best practice.
- Important areas where progress has been made include: climate change, human rights risks assessments, financial practices, and governance standards.

Other

- Trade associations such as Business Roundtable, U.S. Chamber of Commerce, and National Association of Manufacturers are creating a false sense that resolutions are a major burden on companies. However, the vast majority of companies never even receive a shareholder resolution. For those that do, it is notable that often times resolutions end up being withdrawn by the proponent because of conversations between them and the company. Many times this leads to changes beneficial to the company.
- The average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year (ISS Voting Analytics)

Respectfully submitted,

Sr. Ruth Geraets, pbvm

Sr. Ruth Geraets, PBVM
Congregational Treasurer

Sr. Kathleen Bierne, PBVM
Socially Responsible Investing

1500 NORTH 2ND STREET ABERDEEN, SOUTH DAKOTA 57401-1238
PHONE (605) 229-8346 FAX: (605) 229-8563
www.presentationsisters.org

Trinity Health

November 30, 2018

Hon. Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs
713 Hart Senate Office Building
Washington, DC 20510

Re: Proxy Process and Rules: Examinig Current Practices & Potential Changes

Dear Senator Brown,

It is our understanding that the Senate Banking Committee announced that it will be holding a hearing on December 6, 2018 regarding the Shareholder Proxy Process and Rules: Examining Current Practices and Potential Changes. As one of the largest multi-institutional Catholic health care delivery systems in the nation and the parent organization to Mount Carmel Health System in Columbus, Ohio, Trinity Health urges against changes to the current shareholder proposal process. The shareholder proxy process that is in place functions effectively and benefits both shareholders and the long-term well-being of publically held companies.

As a Catholic Health Ministry we believe investment decisions can provide economic prosperity, embrace environmental stewardship and enhance social responsibility. One of the ways Trinity Health lives out its mission to be a compassionate and transforming healing presence is through our Shareholder Advocacy Program. We use our voice as shareowners to engage with corporations to improve corporate decision-making on a number of issues that reflect our mission and core values.

Trinity Health works collaboratively with the Interfaith Center for Corporate Responsibility (ICCR) – a coalition of more than 300 institutional investors collectively representing over $400 billion in invested capital – in its shareholder advocacy efforts. ICCR members represent faith-based organizations including several Catholic Health systems, socially responsible asset management companies, unions, foundations, and other responsible investors working alongside a global network of NGO and business partners.

While our shareholder advocacy work does not shy away from making the moral case for action, our fundamental proposition as investors is that responsible and sustainable business practices - and a strong corporate culture of ethics - are in the long-term interest of both companies and investors. Together we are committed to moving the current business focus away from achieving short-term returns and towards sustainable strategies that advance the common good.

In November, the U.S. Securities and Exchange Commission (SEC) held a Staff Roundtable on the Shareholder Proxy Process. During the roundtable, several areas of the shareholder proposal process were discussed including ownership thresholds, resubmission thresholds, representation of long-term retail investors, the cost of proposals to companies, and the influence of proxy advisory firms. As part of the Roundtable, the SEC has also opened up a comment period on the proxy

Trinity Health

process and related SEC rules. And, now, the Senate Banking Committee is holding a hearing on December 6, 2018 regarding the Shareholder Proxy Process and Rules: Examining Current Practices and Potential Changes.

Based upon our experience as shareholder advocates, Trinity Health holds firmly to the belief that the current rules governing the shareholder resolution process are fair and respect the freedom of the shareholder to express their views. For decades, the shareholder proposal process has served as a cost-effective way for corporate management and boards to hear and address the concerns of all shareholders on issues of sustainability, corporate governance, and risk. We also believe that the SEC's current, rigorous vetting system ensures shareholder proposals are soundly presented, reasonable, and in the long-term best interests of the company and its shareholders.

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard, including those of smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

Historical outcomes demonstrate that the current resubmission thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even receive a shareholder resolution. It is also worth noting that often proponents withdraw resolutions when the resolutions result in a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes.

For example, productive dialogues that Trinity Health had in the early 2000s with the major retailers of video games on the sale of Mature-rated, violent video games to minors led to our withdrawing resolutions after the retailers adopted point-of-sale policies that significantly reduced the sales of these games to youth under 17 (this was documented in surveys by the Federal Trade Commission).

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks they presented to companies. For example, Resolutions with oil and gas companies beginning in 1998 requested reporting on the risks of climate change. In the early years, these resolutions often received below 5% of shareholder support. The 2017 proxy season saw a resolution, of which Trinity Health was a proponent, requesting a business plan in alignment with the 2° C warming threshold established in the Paris

Trinity Health

Climate Agreement achieve a 67% vote at Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources.

We are aware that some trade associations such as Business Roundtable, U.S. Chamber of Commerce, and National Association of Manufacturers have put forth the argument that the shareholder proxy process needs to change because shareholder resolutions are a major burden on companies. However, the evidence does not support this claim. The vast majority of companies never even receive a shareholder resolution. The average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year (ISS Voting Analytics).

For those companies that do receive a resolution, in many instances the resolutions end up being withdrawn by the proponent because of conversations between them and the company. Because of shareholder engagements and resolutions brought by ICCR members and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.

We reiterate our support of the shareholder proposal process as it is currently practiced under Rule 14a-8 and believe altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected.

We appreciate the opportunity to describe the importance of the existing shareholder proposal proposal process and strongly urge that the process be left in place and unchanged. Please feel free to contact me with any questions.

Sincerely,

Tonya K. Wells

Tonya K. Wells
Vice President, Social Impact Investing & Community Development
Trinity Health

Trinity Health

November 30, 2018

Hon. Michael Crapo, Chairman
Committee on Banking, Housing & Urban Affairs
239 Dirksen Senate Building
Washington, DC 20510

Re: Shareholder Proxy Process and Rules: Examinig Current Practices & Potential Changes

Dear Chairman Crapo,

It is our understanding that the Senate Banking Committee announced that it will be holding a hearing on December 6, 2018 regarding the Shareholder Proxy Process and Rules: Examining Current Practices and Potential Changes. As one of the largest multi-institutional Catholic health care delivery systems in the nation and the parent organization to Saint Alphonsus Health System in Boise, Idaho, Trinity Health urges against changes to the current shareholder proposal process. The shareholder proxy process that is in place functions effectively and benefits both shareholders and the long-term well-being of publically held companies.

As a Catholic Health Ministry we believe investment decisions can provide economic prosperity, embrace environmental stewardship and enhance social responsibility. Trinity Health works collaboratively with the Interfaith Center for Corporate Responsibility (ICCR) – a coalition of more than 300 institutional investors collectively representing over $400 billion in invested capital – in its shareholder advocacy efforts. ICCR members represent faith-based organizations including several Catholic Health systems, socially responsible asset management companies, unions, foundations, and other responsible investors working alongside a global network of NGO and business partners.

While our shareholder advocacy work does not shy away from making the moral case for action, our fundamental proposition as investors is that responsible and sustainable business practices - and a strong corporate culture of ethics - are in the long-term interest of both companies and investors. Together we are committed to moving the current business focus away from achieving short-term returns and towards sustainable strategies that advance the common good.

In November, the U.S. Securities and Exchange Commission (SEC) held a Staff Roundtable on the Shareholder Proxy Process. During the roundtable, several areas of the shareholder proposal process were discussed including ownership thresholds, resubmission thresholds, representation of long-term retail investors, the cost of proposals to companies, and the influence of proxy advisory firms. As part of the Roundtable, the SEC has also opened up a comment period on the proxy process and related SEC rules. And, now, the Senate Banking Committee is holding a hearing on December 6, 2018 regarding the Shareholder Proxy Process and Rules: Examining Current Practices and Potential Changes.

Trinity Health

Based upon our experience as shareholder advocates, Trinity Health holds firmly to the belief that the current rules governing the shareholder resolution process are fair and respect the freedom of the shareholder to express their views. For decades, the shareholder proposal process has served as a cost-effective way for corporate management and boards to hear and address the concerns of all shareholders on issues of sustainability, corporate governance, and risk. We also believe that the SEC's current, rigorous vetting system ensures shareholder proposals are soundly presented, reasonable, and in the long-term best interests of the company and its shareholders.

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard, including those of smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

Historical outcomes demonstrate that the current resubmission thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even receive a shareholder resolution. It is also worth noting that often proponents withdraw resolutions when the resolutions result in a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes.

For example, productive dialogues that Trinity Health had in the early 2000s with the major retailers of video games on the sale of Mature-rated, violent video games to minors led to our withdrawing resolutions after the retailers adopted point-of-sale policies that significantly reduced the sales of these games to youth under 17 (this was documented in surveys by the Federal Trade Commission).

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks they presented to companies. For example, Resolutions with oil and gas companies beginning in 1998 requested reporting on the risks of climate change. In the early years, these resolutions often received below 5% of shareholder support. The 2017 proxy season saw a resolution, of which Trinity Health was a proponent, requesting a business plan in alignment with the 2° C warming threshold established in the Paris Climate Agreement achieve a 67% vote at Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources.

We are aware that some trade associations such as Business Roundtable, U.S. Chamber of Commerce, and National Association of Manufacturers have put forth the argument that the

Trinity Health

shareholder proxy process needs to change because shareholder resolutions are a major burden on companies. However, the evidence does not support this claim. The vast majority of companies never even receive a shareholder resolution. The average company receives a shareholder proposal once every 7.7 years, and of those that do, the median number of proposals is one per year (ISS Voting Analytics).

For those companies that do receive a resolution, in many instances the resolutions end up being withdrawn by the proponent because of conversations between them and the company. Because of shareholder engagements and resolutions brought by ICCR members and other responsible investors, longer-term emerging risks with the potential to negatively impact people have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe.

We reiterate our support of the shareholder proposal process as it is currently practiced under Rule 14a-8 and believe altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected.

We appreciate the opportunity to describe the importance of the existing shareholder proposal proposal process and strongly urge that the process be left in place and unchanged. Please feel free to contact me with any questions.

Sincerely,

Tonya K. Wells

Tonya K. Wells
Vice President, Social Impact Investing & Community Development
Trinity Health

Dec. 2, 2017

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs.

Re: File 4- 725 -- Staff Roundtable on the Proxy Process

Dear Sirs,

The Dominican Sisters ~ Grand Rapids have been participating with the Interfaith Center on Corporate Responsibility for 30 years with co-filing, dialogue, and educational efforts. ICCR is a coalition of more than 300 institutional investors collectively representing over $400 billion in invested capital. We endorse their letter (11/5/18) affirming that the current shareholder proposal process as effective, efficient and beneficial to both shareholders and the long-term well-being of the companies they hold.

We would emphasize two elements of their letter: thresholds of ownership and resubmission.

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard including smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

Regarding the issue of resubmission, the current system gives all shareholders time to consider the content of resolutions and make an informed and educated decision on their merits. Consider the progress made with major gas and oil companies. The earliest resolutions received around 5% support which with the proposed rules would have caused them to be "dead in the water!" Given the current procedures, shareholders in subsequent years were able to study and analyze the cause and concerns of these resolutions. Last year, and average of 55% of shareholders of the four major companies supported the concerns of their companies' need to include climate control as an economic reality for the good of the company.

A final note is concerned with the attitude of major trade organizations that our concerns expressed in our resolutions is simply "political." If they understand "political" to be "of the concern of the people" perhaps they are correct. But the concern of the people includes their human right to be included in the just and equitable participation of our economic systems. We are indeed concerned with the profitability of our companies, but we are more concern that our companies are morally responsible for the people we impact.

Respectfully submitted,

Joan Williams, OP
Vicaress
Dominican Sisters ~ Grand Rapids
2025 Fulton Street East
Grand Rapids MI 49503
Direct Line: 616-514-3102

jbwilliams@grdominicans.org

"In a free society, some are guilty; all are responsible."
Abraham Herschel

GREEN CENTURY FUNDS

December 5, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs
U.S. Senate
Washington, DC 20510

Re: Hearing on Proxy Process and Rules; December 6, 2018

Dear Chair Crapo and Ranking Member Brown:

I am writing you on behalf of Green Century Capital Management, Inc. (Green Century) to express our support for the comment letter sent by the Interfaith Center for Corporate Responsibility (ICCR) sent to the SEC on November 6, 2018.

Green Century is a sustainable investment firm representing over $500 million in assets under management and is a member of ICCR. Green Century relies on the current process to ensure that we are able to accurately address and directly discuss the issue of material risk to our investors and fulfill our fiduciary duty. Our ability to file and co-file shareholder proposals is critical to compel companies to address these business, reputational, and material risks. Many times companies are unaware of growing consumer criticisms and activist campaigns that can drive down share price and damage brands. The dialogue that accompanies the filing of a shareholder resolution is the mechanism by which companies get this information and assistance.

We believe that the current shareholder proposal process (structured and administered under SEC Rule 14a-8), fairly serves this purpose effectively. It provides a well-organized, reasonable, and cost-effective way for Green Century, and its investors, to work with companies to hear and address shareholder concerns regarding issues of sustainability, financial and/or reputational risk, and corporate governance; ultimately, helping to serve the best interests of the company and its shareholders. Our long history of corporate engagement has not only created significant value for both our investors and companies alike, but have played a vital role in positively contributing to the welfare of communities and the environment on a global scale.

Therefore, we believe that the current shareholder proposal process is a critical tool that should be preserved.

Sincerely,

Leslie Samuelrich

Leslie Samuelrich
President
Green Century Capital Management, Inc.

Congregation of St. Basil
Corporate Responsibility Director

Margaret Weber
313-938-1133
weber@igc.org

December 3, 2018

Hon. Michael Crapo, Chair
Hon Sherron Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs
U. S. Senate
Washington, DC

Re: Proxy Process and Rules

Dear Senators Crapo and Brown,

On behalf of the Congregation of St. Basil, a member of the Interfaith Center on Corporate Responsibility (ICCR) which has been actively engaged with corporate dialogue and the proxy process, I write to submit comment regarding SEC rules for engagement, specifically Ownership Thresholds and Resubmission Thresholds.

It is our position that there is no need to change either of these Thresholds.

The current ownership threshold deserves to remain as it is: ownership of at least $2,000 worth of a company's shares allows a diversity of investor voices, and the requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors. Shareholders big and small can make and have made valuable contributions to the companies that they own.

Current thresholds for resubmission also should stand. They provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even see a shareholder resolution. It is also worth noting that often resolutions are withdrawn by their proponent after prompting a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes that can transform businesses.

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks presented to companies that they produced. The issue of declassified boards is just one example – in 1987 proposals on this issue received under 10% support; in 2012 - 81%, and it is now considered best practice.

The long-term investors utilizing the proxy process are deeply concerned about the returns on and growth of the investments in their portfolios. They press companies on environmental, social, and governance risks precisely <u>because</u> they are concerned with the long-term health of the companies in which they are invested. The shareholder process enables companies to identify and address reputational and legal risks in advance, before they become liabilities for the company.

In conclusion, we support of the shareholder proposal process as it is currently practiced under Rule 14a-8. Altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected, and one that is critical to long-term shareholder value.

Thank you for this opportunity to provide input.

Sincerely,

Margaret Weber

Margaret Weber
Corporate Responsibility Director
Congregation of St. Basil
313-938-1133

GLASS LEWIS

December 5, 2018

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Democratic Member
Senate Committee on Banking, Housing
and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown,

Thank you for your continued interest in the proxy process and in ensuring that the rights of investors are preserved and protected.

As you are aware, on November 14, 2018, the Securities and Exchange Commission held a day-long roundtable on the proxy process. Amongst those invited to participate were issuers and their trade associations, institutional investors, pension funds, and proxy advisory firms, all of which play an important role in the proxy process. The third panel that day focused on proxy advisory firms, including how investors utilize them, how issuers engage with them, how they develop their methodologies, and how they manage errors and conflicts of interest. A recording of the event can be found at SEC Proxy Roundtable.

In addition to participating as a panelist, Glass Lewis submitted a written statement during the SEC Roundtable comment period, which addresses the questions the SEC thought most relevant as they determine whether any new guidance or rule-making is needed in this area of the capital markets. Glass Lewis would like to provide such statement for the record of the Committee's December 6th hearing, Proxy Process and Rules: Examining Current Practices and Potential Changes.

We appreciate your consideration of the attached written statement submitted by Glass Lewis as part of the SEC Roundtable. Please do not hesitate to contact to me directly should you have any questions.

Sincerely,

Katherine Rabin
Chief Executive Officer

Attachment

SHAREHOLDER RIGHTS GROUP

December 4, 2018

The Honorable Michael Crapo
Chair
Committee on Banking, Housing &
Urban Affairs
US Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking,
Housing & Urban Affairs
US Senate
Washington, D.C. 20510

RE: Hearing on Proxy Process and Rules, December 6, 2018

Dear Chair Crapo and Ranking Member Brown,

I am writing on behalf of the members of the Shareholder Rights Group with regard to the December 6 hearing on the Proxy Process and Rules. The Shareholder Rights Group is comprised of some of the leading proponents of shareholder proposals. The members of Shareholder Rights Group are: Arjuna Capital, As You Sow, Boston Common Asset Management, LLC, CleanYield Asset Management, First Affirmative Financial Network, LLC, Harrington Investments, Inc., Jantz Management, LLC, John Chevedden, Natural Investments LLC, Newground Social Investment, SPC, NorthStar Asset Management Inc., Pax World Funds, the Sustainability Group of Loring, Wolcott & Coolidge LLC, Trillium Asset Management, LLC and Walden Asset Management. Our follow-up comments are confined to issues relating to shareholder proposals filed pursuant to SEC Rule 14a-8.

The November 15 Proxy Process Roundtable of the Securities and Exchange Commission was a constructive exchange of views. We are providing these comments and documentation in advance of your hearing so you will be aware of the facts and to correct some misleading framing of the issues and facts by the Business Roundtable and US Chamber of Commerce raised during the recent SEC Roundtable.

In this letter, references to the "Staff" refers to the personnel of the Securities and Exchange Commission Division of Corporation Finance. Rule 14a-8 refers to the shareholder proposal process under which shareholders can file proposals to appear on a company's proxy statement, subject to stringent legal limitations such as excluding proposals based on a personal grievance, a focus on the ordinary business of a company, or duplicating a previously submitted proposal.

ShareholderRightsGroup.com

PO Box 231 Amherst, MA 01004-0231 • sanfordlewis@strategiccounsel.net • (413) 549-7333

1. SEC POLICYMAKING MUST ALIGN WITH ITS CORE MISSION - THE PROTECTION OF INVESTOR RIGHTS AND INTERESTS.

The SEC's stated mission is:

> The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust.[1]

As it stands now, Rule 14a-8 serves this core mission as a well-functioning mechanism for ensuring that smaller institutional and individual investors can engage with the companies in which they invest, often with their long-term retirement savings.

The SEC, in fulfilling this mission, must recognize the full range of benefits of the shareholder proposal process, and fend off inappropriate attempts to further limit this important engagement and governance tool.

The investor representatives in the Proxy Roundtable Panel including Jonas Kron, James McRitchie, Aeisha Mastagni, and Michael Garland provided ample demonstrations from the perspective of investors participating in the Rule 14a-8 process, regarding the risk management and governance roles of shareholder proposals. A keystone is the role of shareholder proponents of all sizes in deploying the shareholder proposal process to pursue their beneficiaries' long-term investment goals by encouraging foresight, inspiring innovation, and demanding accountability.

The shareholder proposal process is a key governance tool for reconciling the interests of management and investors, between controlling and minority investors, and between investors concerned with short-term and long-term value creation. As a largely self-executing governance mechanism, Rule 14a-8 imposes minimal costs on corporations and society and promotes dynamic self-regulation by the market to address issues that might otherwise become the burden of the courts or the executive branch of government. Some of the proposals advanced in the Roundtable by the Society of Corporate Governance, the Business Roundtable and US Chamber of Commerce could undermine this dynamic.

Facilitating dynamic engagement in the corporate ecosystem

We believe there is a misunderstanding, inherent in the narrow framing by BRT and the US Chamber during the Roundtable and in comments submitted, that the relevant metric for considering significance of shareholder proposals is whether they will achieve a majority vote. Instead, we believe a more appropriate lens for considering shareholder proposals is in its facilitation of dynamic engagement among the corporate ecosystem of investor, board, and management interests.

---

[1] https://www.sec.gov/about.shtml

There are many occasions when a resolution getting 10 or 20 or 24% of the vote stimulated a board discussion, leading to a change of policy or practice. When one recognizes the heterogeneity of actors in the investment ecosystem, it becomes clear that the proposal process is pivotal to reconciling the roles, goals, and results achieved by different subgroups of investors.

The investing landscape reflects diverse strategies and players – long- and short-term, active and passive, individual and institutional, indexed and mission driven. It includes insider investors (directors and executives) who may hold a large or even controlling share of stock and votes, passive investors who typically defer to management's views, active investors, such as hedge fund "activists" who may be seeking to assume control of the company, and an array of other active and engaged subgroups, some of which have competing or conflicting investment strategies or missions.

Investors whose holdings are spread across the economy, so-called universal investors, may need to evaluate and act on cross-portfolio and systemic risks that affect investments throughout the portfolio.[2]

Notably, neither large shareholders like BlackRock, nor controlling shareholders, nor activist hedge fund shareholders typically need to avail themselves of Rule 14a-8 to effectuate their goals. In contrast, individual filers and funds with relatively small holdings do need to make use of Rule 14a-8 to address emerging issues of corporate governance and risk management.[3] These *ahead of the curve* proposals may anticipate issues facing a company and offer new models for improving corporate governance.[4]

The prescience of 5% of investors merits significance and respect: Monsanto Case Study
Even though a proposal receives only a fraction of shareholder support, it may still be the best available opportunity to bring more foresight to investors, board, and management on an issue that may eventually prove costly to a company. Only a small portion of investors may be exercising prescience on risk management or governance issues that will, in fact, prove to be material for the long-term well-being of the company.

In the roundtable discussion and correspondence, corporate representatives have been implying that 3% or 5% of investors supporting a proposal is insignificant, such that the resubmission thresholds should be altered to disallow this minority from having the ability to require continued

---

[2] UNEP-FI, *Universal Ownership: Why Environmental Externalities Matter to Institutional investors* (UNEP-FI, 2011) at 3.

[3] That is because a single individual with knowledge or concerns, and the legal and technical know-how to file a proposal, can effectively raise an issue that they believe is being wrongly ignored.

[4] In contrast, a focus on emerging issues is more difficult at the large investment funds like Blackrock, Fidelity and Vanguard, where scale and legal limitations make turning of focus feel more like turning a ship than a motorboat.

debate and attention to an issue on the annual proxy. Yet, recent developments at Monsanto demonstrate that a subgroup of this size may be prescient in their divergent or contrarian perspective. Allowing them to bring continuing attention and debate could mean the difference between a company that succeeds, and one which fails to take in crucial input beyond the insular boardroom and executive suites.

In 2016, shareholder John Harrington, the president of Harrington Investments Inc., filed a proposal at Monsanto regarding health risks from the company's flagship weedkiller Roundup. The proposal noted "an increasing number of independent studies assessing the toxicity of glyphosate, the active ingredient in Roundup, associate it with cancer, birth defects, kidney disease, and hormone disruption, causing world-wide concern about its safety". The proposal requested that the company issue a report assessing the effectiveness and risks associated with the company's policy responses to public policy developments intended to control pollution and food contamination from glyphosate, including but not limited to the impact of recent reclassification of glyphosate as "probably carcinogenic," and quantifying potential material, financial risks or operational impacts on the Company in the event that proposed bans and restrictions are enacted.

The proposal highlighted that there were very high stakes for investors:

> Combined with "Roundup Ready" crops, almost our entire revenue stream is based on one product which, until recently, has enjoyed a measure of regulatory leniency. However, an October 2014 report by the U.S. Government Accountability Office reporting a lack of testing of glyphosate residues in food by the Food and Drug Administration and the March 2015 reclassification by the International Agency for Research on Cancer of the World Health Organization of glyphosate as "probably carcinogenic to humans" may substantially increase overall legal and financial risk, damaging our company's name brand and corporate reputation.

The proposal was vigorously opposed by the company, which asserted that the new World Health Organization position presented a minority view among the scientific community that the company disagreed with. On its 2016 vote, the proposal received 5.3% voting support. Refiled in 2017, it still only received 5.5% support. Because this amount is less than the current 6% threshold, the proposal would not have been eligible for resubmission in 2018. Yet, this relatively small group of shareholders had been prescient in identifying a material issue.

Only two months after Monsanto was acquired by the German pharmaceutical company Bayer in June 2018, a jury granted a $289 million award in a suit alleging public health threats and cancer of a plaintiff caused by Roundup. This news sliced billions of dollars from Bayer's valuation. Bayer's market capitalization has descended steeply in the following months, from $99.1 billion as of August 10, 2018 (the date of the jury verdict), to $64.8 billion as of November 20, 2018.

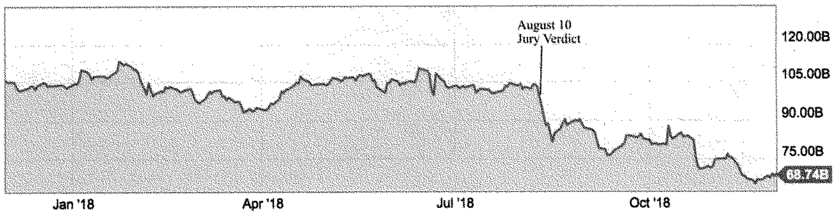


Figure 1 Bayer Market Capitalization Before and after the Jury Verdict

The litigation continues to grow. According to the Wall Street Journal, in August 2018 there were 8700 plaintiffs; by the end of October 2018 there were 9300 plaintiffs. Even though the jury award was later reduced to $40 million, the potential payouts on this litigation are capable of exceeding the entire market capitalization of Bayer.

Monsanto has employed a "circling the wagons" strategy on glyphosate by working to discredit the scientists and international scientific bodies that have found glyphosate risks. Academic reviews of the company documents released in the litigation have uncovered questionable strategies deployed by the company. This includes evidence that "independent" studies on glyphosate had been ghostwritten by the company's own staff, that the company had attempted to interfere with journal publication, and had gone to extraordinary lengths to influence the Environmental Protection Agency's regulatory analysis.[5]

One may debate why only 5% of the investors supported additional disclosure on this issue. Perhaps many were hopeful that the circle the wagons strategy would continue to work well, as it had in the past. Some may have simply believed the company's assertions. But it must be said that given the potential for 5% of investors to prove this prescient in regard to long-term material issues, it should be recognized that removing a proposal from the proxy may bury a long-term material issue that is in the best interests of all investors if it is allowed to be perpetuated on the proxy. It would not seem in the interests of investors or the capital markets for the SEC to so truncate the opportunity for the prescient investors to persuade others of real risk factors.

When a company is circling the wagons to defend against product liability litigation, the outcome often leaves the company's shareholders in the dark as to the substantial downside risks obfuscated by this approach. The shareholder proposal sought a more balanced discussion of the potential downsides and liabilities should the circle the wagons approach fail to fend off the increasing likelihood of litigation and an emerging scientific view finding greater risk. Instead of providing a balanced discussion of downside risks, the company's response was to hyper-focus on discrediting the science.

---

[5] Krimsky, S. & Gillam, Roundup litigation discovery documents: implications for public health and journal ethics, C. J Public Health Pol (2018) 39: 318. https://doi.org/10.1057/s41271-018-0134-z

As a result,"Bayer's reputation with investors has been diminished," said Markus Mayer, an analyst with Baader Bank. "The latest increase in the number of cases highlights the challenge for Bayer to assuage investor concerns that its acquisition of Monsanto this year had burdened the pharmaceutical and chemicals company with a problem that could take years to resolve and could weigh on its share price for some."[6]. "The market doesn't know how this story will end, no one wants to get in right now."[7] The Company's former CEO has noted that the lawsuits will occupy the company beyond 2021 as they work their way through the courts.

Integrating long and short-term perspectives and metrics

The Monsanto example demonstrates that issues that we may call long-term may actually have an impact on a company or on society much earlier than expected. Nevertheless, the notion that a portion of shareholders can reflect a different perspective on risk and on long-term implications through the proposal process seems pivotal to policy consideration.

Despite the proliferation of reports encouraging companies and investors to take a longer term view, company managers continue to perceive pressures for short-term performance as pervasive. A recent study commissioned by the think-tank ***Focusing Capital on the Long Term*** suggested 87 per cent of executives feel pressure to deliver results within two years or less. The think tank notes:

> *Too many investors continue to seek returns on their strategies as quickly as possible. Companies are missing out on profitable investments for fear of missing quarterly earnings guidance. Corporate management significantly undervalues and underinvests in longer-term prospects. Savers are missing out on potential returns because stock markets are penalizing companies that make long-term investments. Society is missing out on long-term growth and innovation because of underinvestment.*[8]

These pressures derive both from market responses to the metrics contained in company quarterly reports, but also in response to particular subgroups of shareholders that may engage in power plays to demand actions that boost returns in the short term.

The shareholder proposal process is one of the best tools for the shareholders who have the long-term interest of America's retirement funds in mind. While quarterly financial reports provide SEC-mandated corporate metrics, the availability and significance of longer-term corporate metrics is a core issue raised in many proposals. Decades of shareholder proposals have effectively persuaded hundreds of companies to produce annual sustainability reports and other

[6] Ruth Bender, Bayer Hit by More Lawsuits Over Safety of Roundup Weedkiller, Bloomberg, November 13, 2018.

[7] Ruth Bender, Bayer Pursued Monsanto Despite Weedkiller Suits and Executive's Concern, Bloomberg News, Nov. 25, 2018.

[8] Focusing Capital on the Long Term, "A roadmap for focusing capital on the long term," March 2015, pp 2. http://www.fcltglobal.org/docs/default-source/default-document-library/a-roadmap-for-fclt.pdf?sfvrsn=7b2c258c_0

key environmental and social metrics of interest to investors.[9]

Key to long-term metrics is the term "ESG", which represents environmental social and governance issues and metrics. ESG has come to express the notion of core data regarding responses to issues that are likely to be long-term concerns and therefore relevant to long-term management. This relationship is well understood, even by investors that are not official sponsors of ESG proposals. For instance, Larry Fink, the chief executive of BlackRock, the world's largest investor, has noted in his annual letter to investors that "ESG factors relevant to a company's business can provide essential insights into management effectiveness and thus a company's long-term prospects."

Of particular note and importance recently is the role of shareholder proposals in improving ESG disclosure and performance. Investors often use shareholder proposals to shed light on emerging issues not yet on the agenda of boards and management. Many current beneficial corporate practices, such as climate change strategies, pollution prevention, board gender diversity, and work place inclusion have been substantially initiated and shaped by shareholder proposals and resulting shareholder engagement.

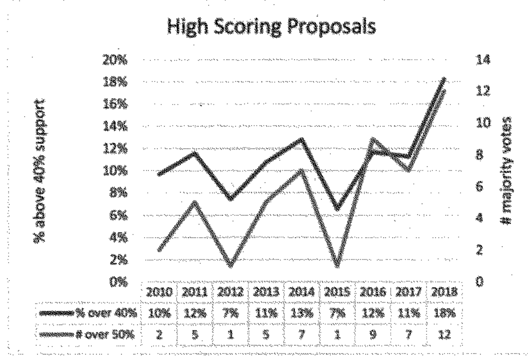
There is a rich literature documenting the costs and risks associated with poor ESG management. Companies that score lower on ESG ratings are known to be "accident-prone" and of heightened bankruptcy risk. For instance, Bank of America Merrill Lynch found that ESG metrics are a powerful tool for avoiding disaster in disaster-prone companies:

> "ESG has been a better signal of future earnings volatility more than any other measure we have observed at a market level."[10]
>
> "ESG could have helped investors avoid 90% of bankruptcies: based on our analysis of companies with ESG scores that declared bankruptcy, an investor who only held stocks with above average-ranks on both Environmental and Social scores would have avoided 15 of the 17 bankruptcies we have seen since 2008."

Any rulemaking changes that undercut ESG disclosure improvements or which silence the minority of shareholders that may be flagging a critical ESG issue must be weighed against the increased risks associated with omitting those proposals.

---

[9] In 2016, hundreds of investors wrote to the Securities and Exchange Commission urging the establishment of mandatory disclosure metrics on environmental and social issues.SASB, Blog, August 16, 2016, pp 1 https://www.sasb.org/investors-sec-sustainability-disclosure/. In 2018 a petition filed with the SEC amplified this message and asserted that the time for action has arrived.
[10] Equity Strategy Focus Point, ESG Part II: a deeper dive, Bank of America Merrill Lynch, June 15, 2017.



Source: Sustainable Investments Institute, November 2018

Figure 2 Support for ESG Proposals is growing

Proposals addressing long-term financial risk
ESG proposals, together with other financially focused proposals, have contributed to a companies' long-term prospects by helping them avoid looming liabilities or reputational harm, and to capitalize on unrecognized opportunities. To cite one example, the financial crisis of 2008 was brought on by short-sighted decisions that proliferated in the 1990s regarding subprime lending and securitization strategies that eventually placed the whole economy at risk. Some religious pension fund shareholders began flagging these issues back in 2000 through the shareholder proposal process, and in so doing assisted many companies that cooperated, to avoid the disastrous fate met by numerous big banks.[11]

Governance proposals and market value
As a policymaker, the SEC must recognize and value these benefits of the shareholder proposal process even though those benefits are not always subject to simple monetization or

---

[11] As Attorney Paul Neuhauser has noted: "The first shareholder proposals concerning predatory subprime lending were submitted in 2000 and the first asking securitizers to police the loan pool were submitted in 2003, in each case years before subprime lending became recognized as a major problem. The shareholder proposals constituted an early warning system for those who heeded them. Although these proposals were submitted to a number of companies and survived company challenges at the SEC, they never appeared on any proxy statement because the recipients in each case agreed to a change of policy with regard to predatory lending to subprime borrowers (in one case the securitizer called the proponent the day after it lost its no-action request at the SEC to request a meeting and dialogue on the matter and at the meeting agreed to alter its due diligence process with respect to loans purchased for securitization). Notably, the securitizers that received the precatory proposals and changed their practices have not been among those who have suffered during the recent unpleasantness." Paul Neuhauser, comment letter to SEC, Oct. 2, 2007, https://www.sec.gov/comments/s7-16-07/s71607-476.pdf

quantification. For example, governance measures that improve the ability of investors to hold management accountable, such as proxy access, separating the CEO and board chair, and special meeting thresholds proposals, significantly contribute to the better governance of corporations. There is literature demonstrating that a better governed corporation is valued by the market with increased stock value. [12] Yet, the value associated with good governance is wide-ranging and only very partially reflected in those stock studies. It includes avoided costs to corporations and government due to other forms of recourse that would become more necessary if the shareholder proposal process becomes less available, liability avoidance, reduction of externalities to society, and the value added by longer-term corporate strategies than might otherwise result if guided solely by market pressures in the absence of this essential corrective tool.

2. CURRENT FILING THRESHOLDS AND HOLDING PERIOD ARE EFFECTIVE.

Some of the corporate representatives on the Roundtable panel asserted that there is an appropriate dividing line between institutional investors who tend to treat the proposal process as a "last resort" and retail investors who may be more apt to resort to the proposal process without effective prior engagement with a company. An important point which cannot be overemphasized is that larger investors often do not need the shareholder proposal process in order to persuade companies to engage with them on their concerns. In contrast, the shareholder proposal process provides an appropriate avenue through which all shareholders, including Main Street's shareholders, as well as their chosen representatives, can raise issues and elicit consideration and support from their fellow shareholders. As this support grows, boards and managers tend to be more responsive to the concerns raised.

Given the beneficial role that smaller shareholders play in leadership, governance and innovation through the proposal process, we believe it is not appropriate to elevate filing thresholds, increasing the amount of stock required to be held in order to file a proposal. There are adequate limitations in the existing exclusions of Rule 14a-8 to prevent "special interest" or frivolous proposals. [13] Further, there has been no substantiation presented to justify increasing the amount of stock required to be held in order to file a proposal.

In addition, several commenters from the issuer's perspective suggested that the SEC should require shareholders to hold their shares for longer than one year (e.g. three years) before filing a proposal. In contrast, panelist Jonas Kron suggested that in some instances a year is too long a holding period. The idea of lengthening the holding period for filing a proposal seems fundamentally out of line with the dynamic of today's market in which fewer shareholders are exercising "buy-and-hold" investment strategies that must compete with high-frequency trading

---

[12] See, eg., Sekhar Muni Amba, Corporate governance and firms' financial performance, Journal of Academic and Business Ethics, Volume 8, July 2014. http://www.aabri.com/manuscripts/131587.pdf

[13] The exclusions are found in Rule 14a-8(i).

and index funds. The average time an investor held a share holding a stock in the 1960s when the rule was passed was eight years, today it is between four and eight months.[14]

3. THE SEC MUST AVOID RELIANCE ON INACCURATE AND UNSUBSTANTIATED COST ESTIMATES AND SKEWED DATA SOURCES.

Unsubstantiated Cost Estimates
The Society of Corporate Governance and Blackrock, among others, submitted comments with a highly exaggerated and unsubstantiated cost figure advanced by the U.S. Chamber of Commerce Center for Capital Markets Competitiveness claiming a cost of $87,000 per shareholder proposal. In fact, as reported by US SIF, Ceres, and ICCR, this often cited figure originates from the misapplication of data gathered in an SEC questionnaire, and in our experience is out of line with reality.

First, the SEC asked how much it costs companies per year to determine whether or not to include shareholder proposals, including compliance with exclusion rules and procedures. Because the question was ambiguously worded, the average figure of $37,000 per year arguably applied to the total cost to companies of considering whether or not to include ***all proposals--not*** the cost per proposal. The wide range of responses to the question from $10 to $1,200,000 (a median value of $10,000) also reflects the ambiguous presentation of the issue and question. Similarly, the SEC reported survey results indicating an average cost of $50,000 to publish proposals, and as with the first question it appeared that this may be the average cost for including all proposals in the proxy, rather than a per proposal expense. Most companies receive few, if any, shareholder proposals. [15]

It has also been suggested in some of the comments that the real cost of the proposal process is not the cost of the no action challenges to proposals, but rather the cost in ***attention*** for the board and management. We believe that such attention is not only generally appropriate, but that the shareholder proposal process provides an attention *benefit* at least as often, because it allows boards to surmount a tendency toward insularity and groupthink.

Furthermore, the Staff has recently established a mechanism whereby a Board of Directors is free to demonstrate in the no action process that a proposal raises an issue that is "insignificant" to a company. Notably, efforts by companies to utilize this new procedure have largely fallen flat. We believe this is because it is not in the interest of proponents to raise an issue that is truly not significant to the company.

Proxy Monitor focus on Fortune 250 skews analysis of proposals

[14] https://www.politifact.com/virginia/statements/2016/jul/06/mark-warner/mark-warner-says-average-holding-time-stocks-has-f/ see also Jake Zamansky, The Death of the "Buy and Hold" Investor, Forbes, Jul 5, 2012 http://forbes.com/sites/jakezamansky/2012/07/05/the-death-of-the-buy-and-hold-investor/#45702d5a30b9

[15] The Business Case for the Current SEC Shareholder Proposal Process, April 2017, Published by US SIF, ICCR and Ceres https://www.ussif.org/files/Public_Policy/Comment_Letters/Business%20Case%20for%2014a-8.pdf

Both the Business Roundtable and the US Chamber of Commerce Center for Capital Markets Competitiveness comments submitted to the Roundtable docket make use of data from Proxy Monitor. This data analyzes proposals filed at the Fortune 250, and as such presents a skewed analysis. Because many proponents file at companies outside the Fortune 250, this Proxy Monitor data yields an inaccurate sense of the frequency of filings.

The Sustainable Investments Institute (Si2)[16] analyzes a larger universe of concern than the Proxy Monitor data, and finds different outcomes. Si2's data demonstrates that the proportion of proposals leading to productive engagement is underrepresented by Proxy Monitor's data. To get a full picture of investor engagement, one must analyze all filings. This information is non-public unless a) proponent provides publicity in a press release or other announcement or b) the resolution is challenged at the SEC with a no-action letter. For instance, when it comes to analysis of engagement, Si2 finds that a high proportions of resolutions seeking sexual orientation policies, board diversity policies/reporting and sustainability reports get withdrawn at companies beyond the Fortune 250.

The Proxy Monitor data also is not normalized to SEC methods of vote counting as reflected in the resubmission thresholds, but rather rely on company specific standards and therefore do not allow effective cross comparison between companies on levels of support for issues.

4. CLOSER EXAMINATION OF DATA REGARDING RESUBMISSION THRESHOLDS DIMINISHES THE ARGUMENTS IN SUPPORT OF ALTERING THE THRESHOLDS.

The resubmission thresholds of Rule 14a-8 reflect an ongoing and evolving deliberative process in the ecosystem of investors expressed through education, policy development, engagement and persistence._Ultimately, the success of any shareholder proposal may depend on being able to make that *business case* to other shareholders. If a proposal does not win a baseline of support from fellow shareholders, the idea is taken off the agenda for several subsequent annual meetings.[17]

The SEC thresholds for resubmission of a proposal, require 3%, 6% and 10% support of shareholders respectively over the first three years of submission. Gaining additional support may in some instances happen rapidly. In other instances, where the materiality of a proposal's focus is not yet widely understood, support beyond the 10% threshold may abruptly change in a subsequent year with the evolution (or disruptive developments) in market conditions, policy

[16] https://corpgov.law.harvard.edu/2013/09/16/accuracy-in-proxy-monitoring-2/
[17] The existing threshold require that a proposal at least 3% support the first year is introduced, 6% the second year and 10% the third year, otherwise they are taken off the proxy. SEC Rule 14a-8(i)(12).

making, and investing strategies. Most importantly, larger shareholders often support a proposal only after it is no longer seen as a "flash in the pan" –i.e. once it has persisted long enough for slower moving, larger investment firms to establish a voting policy relevant to the specific issue raised.

Sometimes the subject matter of a proposal may linger on the proxy for a course of years before becoming widely supported. For instance, proposals at Exxon Mobil asking the company to assess the impact of climate change on its business model tended to get 10% support over the course of decades. However, shareholder support jumped to 30% support in 2016 and then 62.3% support at its annual meeting in 2017.

The Council of Institutional Investors submitted a detailed report and data analysis regarding the resubmissions thresholds.[18] The report was intended to evaluate the impact of the resubmission thresholds proposed under the Financial CHOICE Act, which would raise thresholds from the current 3-5-10 to 6-15-30. Although the CII report included important data, the analysis included with the report neglected to highlight what we believe to be some of the most significant and relevant implications of this data.

First-time submittals with low votes.
The data demonstrates an appropriate level of restraint by shareholders, who are not reflexively refiling proposals. Only one third of proposals that received less than 6% support when submitted the first time were resubmitted a second time.

In addition, some of the proposals resubmitted do indeed gain support on refiling. Of the 74 proposals refiled between 2011 and 2018 with under 6% support, eight of the proposals, or roughly one in 10 were able to garner substantially larger support the second time they were submitted, including several that achieved majority support when submitted a second time. The continuation of a total of 74 proposals during this timeframe in order to allow 10 of them to garner additional support seems proportional and not an inappropriate outcome of the functioning of the current rule.

Examples of increased support in subsequent filings included a proposal on proxy access that received 4.4% support the first year it was filed at Netflix but won a majority vote when refiled two years later. Similarly, proxy access proposals at Cisco, Citigroup, and Apple jumped significantly from relatively low support the first year to much more significant support in a second filing. Other proposals that rose from under 6% support in the first filing to substantial support in a second resubmission included Walgreens Boots Alliance from 5.7% support the first time a proposal linking sustainability metrics to compensation came up to 23% support the second time. Other proposals with similar jumps include human rights risk disclosure at Amazon.com, and Procter & Gamble's proposal on unrecyclable packaging. These increases in support are demonstrations of the manner in which significant shareholder education or emerging issues elicit greater support from the first submission to the second.

[18] Brandon Whitehill, *Clearing the Bar: Shareholder Proposals and Resubmission Thresholds*, Council of Institutional Investors, November 2108. https://www.sec.gov/comments/4-725/4725-4630831-176413.pdf

Lingering proposals
The Council of Institutional Investors analysis identified a total of 38 proposals from 2011 to 2018 that eventually drew significant shareholder support which would have been blocked if the CHOICE Act's proposed limits of 6-15-30 were put into effect.

In addition to the above examples, there were a number of proposals that eventually won significant support, but that would have been eventually excluded if the second and third year thresholds were raised to 15% and 30%. These included six proposals for an independent board chair (UMB Financial, American Express, AutoNation, Chevron, Wendy's, and KeyCorp), twelve proposals seeking disclosure of political contributions or lobbying payments (Wynn Resorts, Allstate, Republic Services, Nike, FedEx, Express Scripts, Charles Schwab, IBM, Citigroup, Verizon, UnitedHealth Group, and Devon Energy), three proposals urging One Share One Vote (Alphabet, United Parcel Service, and Telephone and Data Systems), and numerous other proposals.[19]

The eventual shareholder support demonstrating substantial interest in these issues shows that the process is working, and that the opportunity to weigh in on these matters over a course of years is valued by investors. Retaining the topics on the proxy allows shareholders to exercise prerogatives of shareholder democracy – to debate and deliberate, and to evolve their opinions on a timely basis as concerns and issues emerge.

Private ordering value of resubmission thresholds not reflected in CII data or analysis
There is an additional important omission from the CII data and analysis regarding resubmissions, as the report's data does not illuminate the issue of private ordering and engagement spurred after proposals cross the current 3%, 6% and 10% thresholds. It has been noted in the comments submitted by the Interfaith Center on Corporate Responsibility[20] that about a third of proposals are withdrawn because they produce effective engagement.

Meanwhile, the CII data only show the proposals ***that were refiled*** and appeared on the proxy. They do not provide necessary analysis of the private ordering impact of proposals that are filed and later withdrawn, nor of the private ordering impacts that exist because access to the shareholder proposal process exists. In our experience, there are many instances in which a proposal is NOT refiled because the successful vote above the current resubmission threshold leads to an engagement that obviates the need for a proposal.

The aforementioned trade associations implied that the fact that some proposals may receive less than 50% support year after year shows they are not appropriate for resubmission. But shareholder proposals prompt effective engagement, and sometimes the proponents must persist

[19] These include an array of other issues — stock retention holding periods (Verizon), coal combustion waste (Ameren), Proxy Access at Urban Outfitters, pro rata vesting of equity awards at Comcast and McKesson, employment diversity at Charles Schwab and Omnicom and unrecyclable packaging at Kroger.

[20] https://www.sec.gov/comments/4-725/4725-4621915-176393.pdf

over a course of years. These benefits are not reflected in the data and analysis and merit substantial consideration by the Securities and Exchange Commission as they reflect some of the most valuable outcomes generated by the proposal process.

An increasing number of withdrawals illustrate some of the positive results of effective engagement:

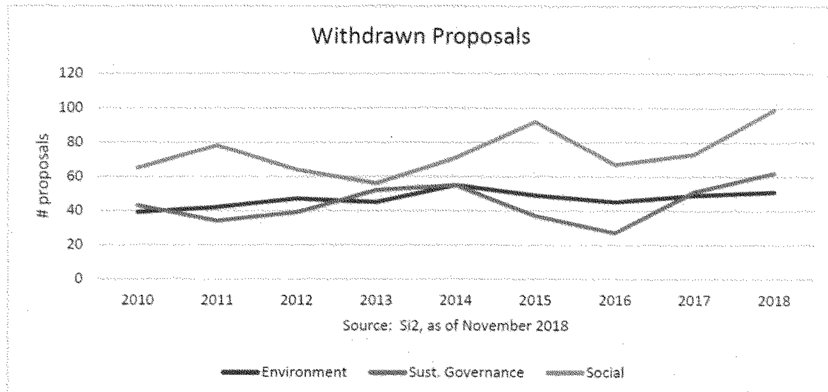


Figure 3 More ESG proposals are being withdrawn, in part due to successful engagement

Cost of resubmissions is likely significantly less than cost of first-time proposals
As we noted above, the costs of the shareholder proposal process have been exaggerated by the trade associations. But even so, we believe it is important for the SEC to recognize that the cost of *resubmission* of proposals is likely to be significantly less than the cost of first-time proposals. Our experience as proponents of proposals leads us to believe that companies expend less resources on proposals that are resubmitted. If resources are expended in opposition to proposals, the lion's share of those resources and board attention to a proposal are most likely expended in the first effort to oppose the proposal.

5. **FILING OF PROPOSALS BY AN AGENT OF A SHARE OWNER IS A PROTECTED RIGHT UNDER STATE LAW AND SHOULD NOT BE UNDERMINED BY SEC REGULATION.**

During the Roundtable there were several comments seeking to limit the ability of shareholders to rely on an agent to file a proposal on their behalf. These discussions were framed in the somewhat confusing nomenclature of "filing by proxy." In fact, it is a long-standing practice for shareholders to exercise their right to file proposals via agents, investment managers, experts, advisors, and lawyers who file proposals on behalf of a shareowner, and whose agency may also have been requested, as representative of the shareholders' interests, or wishes regarding an investment strategy, to engage with companies on their behalf. Just as issuers are able to hire a lawyer to file a no action request, and otherwise channel correspondence regarding a shareholder proposal through their attorneys, so are shareholders entitled as a matter of state law to hire an array of agents, analysts and representatives to exercise their rights to engage with their investee companies. It is neither necessary nor appropriate for an individual or institutional shareholder to be required to engage in direct communication with issuers.

The Securities and Exchange Commission Staff already addressed this concern of some issuers in 2017 in Staff Legal Bulletin 14 I which noted:

> There have also been concerns raised that shareholders may not know that proposals are being submitted on their behalf. In light of these challenges and concerns, and to help the staff and companies better evaluate whether the eligibility requirements of Rule 14a-8(b) have been satisfied, going forward, the staff will look to whether the shareholders who submit a proposal by proxy provide documentation describing the shareholder's delegation of authority to the proxy. In general, we would expect this documentation to:
>
> - identify the shareholder-proponent and the person or entity selected as proxy;
> - identify the company to which the proposal is directed;
> - identify the annual or special meeting for which the proposal is submitted;
> - identify the specific proposal to be submitted (e.g., proposal to lower the threshold for calling a special meeting from 25% to 10%); and
> - be signed and dated by the shareholder.
>
> We believe this documentation will help alleviate concerns about proposals by proxy, and will also help companies and the staff better evaluate whether the eligibility requirements of Rule 14a-8(b) have been satisfied in connection with a proposal's submission by proxy. Where this information is not provided, there may be a basis to exclude the proposal under Rule 14a-8(b).

This new requirement which the staff imposed only recently, demands significantly more specificity, documentation, and disclosure from shareholders. It has so far only been tested for a single season. To our knowledge, there have been as yet no demonstrations, including in the roundtable, to indicate that this new requirement is failing to address the underlying concerns.

6. THE PURPOSES OF RULE 14A-8 WOULD NOT BE ADVANCED BY *REQUIRING* ENGAGEMENT.

Some commenters suggested that there should be a requirement for the proponent and/or their "proxy" to attempt to engage at least once with a target company prior to filing a proposal. While in some instances, proponents and their investee companies may find it efficacious for engagement to occur, Rule 14a-8 is not based on an assumption of engagement by all share owners. Some proponents of proposals do not file proposals primarily in order to engage with management, but more as a means of communication and consensus building with fellow shareholders. This is clearly an equally appropriate function under the rule.

Similarly, there were recommendations in the Roundtable that there be *disclosure* of any engagement that happened in a proposal or no action defense. We note that the Staff has already invited boards of directors who wish to assert that a proposal is "insignificant" to discuss any engagement with shareholders for purposes of Staff Legal Bulletins 14I and 14J.

Furthermore, under the current implementation of the rule and Staff Legal Bulletins 14I and 14J either the proponent or a company is already free to discuss whatever engagement has transpired, addressing arguments related to significance and relevance under Rules 14a-8(i)(7) and Rule 14a-8(i)(5).

7. A FUTURE STAFF LEGAL BULLETIN, OR CHANGING THE APPROACH TAKEN IN NO ACTION LETTERS, CAN RECTIFY NEW IMPEDIMENTS TO SHAREHOLDER RIGHTS.

We previously submitted to the Division of Corporation Finance on July 2, 2018 a report regarding the recent developments in the no action process, along with our recommendations for improvements that could be implemented through a staff legal bulletin.[21]. Our analysis concluded that certain changes in SEC practices during the 2017-2018 proxy season raised serious threats to the rights of proponents to file proposals that are of material interest to investors. We included recommendations for additional SEC guidance to temper the damage done by recent Staff rulings.

We note that the Staff Legal Bulletin 14J responded to one of our recommendations, to provide clarifying guidance regarding the obligations of boards of directors to document substantively the basis for finding a proposal to be "insignificant" or "irrelevant" to a company. However, it has fallen short in addressing a number of our concerns. We will reiterate a few of the key outstanding concerns and issues here.

Micromanagement

While applying long-standing language and doctrines to justify its decisions, we interpret recent

---

[21] Proxy Season 2018:Shareholder Proposal Decision-Making of the Securities and Exchange Commission, Analysis and Recommendations of the Shareholder Rights Group, July 2, 2018. http://bit.ly/SRGReportJuly2018

rulings by the Staff as a departure from its prior approach to ascertaining whether a proposal engages in micromanagement under 14a-8(i)(7). As stated in the 1998 Release, the ordinary business exclusion is intended to "confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for the shareholders to decide how to solve such problems at an annual shareholders meeting." In applying this principle to micromanagement, the Release stated that micromanagement involved "probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."

Consistent with this rationale, micromanagement exclusions have historically been limited to proposals that sought to manage the minutiae of the company's business and not to proposals addressing material questions of business strategy associated with a significant policy issue. During 2017 and 2018, the Staff found in a number of instances where a company had existing policies on a complex issue, that even proposals seeking top-level action on those issues constituted micromanagement. We remain concerned that the emerging approach by the staff represents a radical departure from the past, potentially foreclosing proposals on a very wide range of material and significant policy matters where the scale, pace, or rigor of management responses is at issue.

A key example raising this concern is the decision in *EOG Resources, Inc.* (February 26, 2018)[22] where the proposal asked the company to set targets for the reduction of greenhouse gas (GHG) emissions. The proposal did not seek to dictate minutiae. It left management with full discretion to determine the timing, scope, and magnitude of appropriate targets. Yet, the Staff allowed the proposal to be omitted on the basis of micromanagement, even though it sought the adoption of a high-level business strategy commonly deployed by many other large companies on a widely recognized, significant policy issue facing the company and society.

The EOG proposal did not raise an off-limits point for shareholder deliberation but rather a topic that is routinely voted upon and well supported by shareholders. Because the same proposal model submitted to EOG Resources had been deemed in prior no-action decisions to not constitute micromanagement, the proposal on GHG targets has been filed at dozens of companies since 2010 and has received voting support averaging above 20%. In 2018, at Emerson Electric and Fluor Corporation the proposals earned around 40% support. The proposal has also been withdrawn by investors at numerous companies that have agreed to set targets. Overall, more than 400 companies have committed to set science-based targets for GHG emission reductions to date.

The change in approach could have wide-ranging and deleterious implications, including limiting the availability of shareholder proposals at companies that already have disclosure and policy frameworks in place, which a significant portion of shareholders view as boilerplate or grossly inadequate. At a time in which shareholder proposals on climate change are receiving unprecedented levels of voting support (including many majority votes) and investors like

[22] https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2018/trilliummiller022618-14a8.pdf

JPMorgan, BlackRock, and PIMCO are asking companies about greenhouse gas reduction targets, the micromanagement rulings interfere with functioning market mechanisms.

This year's Staff Legal Bulletin 14J states that reports and studies requested in proposals can be subject to micromanagement exclusion if the substance of the report relates to the "imposition or assumption of specific time frames or methods for implementing complex policies." It is important to keep in mind that in today's corporations, most policies are "complex". Request for improvement of those policies requires a reasonable level of specificity to not be found vague or even already substantially implemented on the basis of a very general policy of the company, even if such a policy has not been effectively implemented by the company.

We believe that it is incumbent on the Staff to clarify through no action letters or a new SLB that micromanagement will not be found in instances where it is reasonable and practical for shareholders to weigh in on the issue raised by the proposal. For instance, the SEC can consider evidence that similar proposals were considered elsewhere. The rulings and guidance should make it clear that shareholders have a right to ask companies to do better on the pace, scale and rigor of their responses to significant policy issues, as long as the proposal does not prescribe an inappropriate level of detail.

Conflicting proposals
In 2017 and 2018 the Staff developed a new approach to the interpretation of Rule 14a-8(i)(9) this season, effectively allowing companies to "game the system" by simply offering a proposal to ratify business as usual – after receiving a shareholder's governance reform proposal. Although a Staff requirement for the proxy statement to mention the excluded proposal may help inform investors, such an approach may undermine the rights and logic of shareholders being able to request specific reforms. Ratification of the status quo in lieu of a shareholder's proposal, besides being unnecessary, means that shareholders only get to hear one side of an issue and avoids productive debate.

The Staff should limit exclusions to instances where two binding proposals could not both be legally enacted simultaneously without creating a legal conflict. Advisory proposals as a general proposition, cannot conflict with management proposals. There should be a rebuttable presumption against a "conflict" when management seeks ratification of an existing policy.

Providing additional detail in no action decisions
In our July 2 report we urged that the Staff provide additional detail in no-action decisions, by expressly applying the rule to the facts and language of the proposal to clarify the dispositive issues. This practice could eliminate guesswork and for "kitchen sink" arguments in no-action correspondence, and provide clearer guidance in future proposal filings.

CONCLUSION

Rather than initiating a rulemaking and constraining shareholder rights to file proposals, we believe improvements can be made to better defend shareholder rights through the no action process and staff legal bulletins. Retail investor engagement can best be advanced as suggested in the roundtable by James McRitchie. The Commission can and should provide basic education to shareholders on their responsibility to cast votes on these issues of long-term value creation, as well as on their rights and responsibilities to file proposals.

Thank you for this opportunity to comment. If we may provide additional information on these issues, please contact us at sanfordlewis@strategiccounsel.net or 413 549-7333.

Respectfully Submitted,

Sanford Lewis
Director
Shareholder Rights Group

Si²
Sustainable
Investments
Institute

Proxy Season Review:

Social, Environmental & Sustainable Governance Shareholder Proposals in 2018

By Heidi Welsh

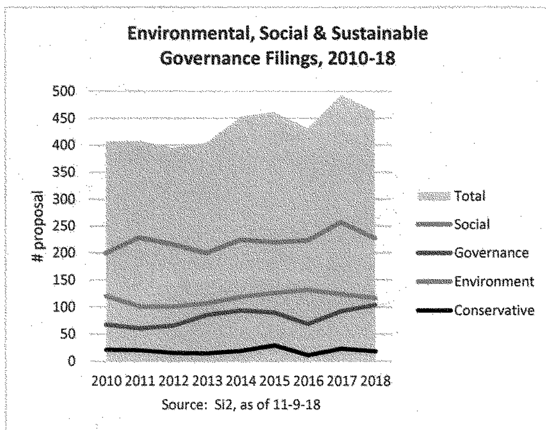
November 9, 2018

Table of Contents

OVERVIEW

Investor support for a wide range of shareholder proposals on social and environmental issues increased in 2018; 12 proposals earned majority support, even on issues that previously received little shareholder approval, more than ever before. This appears to show increasing traction among investors for a broad range of "non-financial" concerns, which is reflected in increasing support from large mutual fund families, proxy advisors and other investors. It is particularly notable with respect to climate change.

The majorities occurred on hot-button issues that attracted support from the same big mutual funds that changed the landscape of proxy voting in 2017, with a 69 percent vote in favor of gun safety reporting at **Sturm, Ruger** and 52.2 percent for the same resolution at **American Outdoor Brands.** Investors also gave majority support for reporting on the risks associated with the opioid crisis—62 percent at **Depomed** and 61.4 percent at **Rite Aid.**[1] *(Table, pp.7-8, shows all the majority votes.)* Majority support occurred for eight more proposals on climate change and sustainability disclosure, including 80 percent supporting sustainability reporting at **Rite Aid**.



A total of 464 resolutions were filed on social, environmental and sustainable governance topics, down some from the nearly 500 in 2017. Proponents withdrew 212 proposals, 66 were left out of proxy statements (omitted) after company challenges at the SEC and three remain pending for **Oracle's** Nov. 14 annual meeting, on lobbying, election spending and gender/minority employee pay equity.

Major Themes

Climate Change

Proponents withdrew most of the resolutions seeking reports on how companies are planning to adjust their business models so the goals of the Paris Climate Treaty can be met, because companies agreed to issue the reports. Yet few energy companies appear to be contemplating fundamental business model changes that will be needed to keep global temperatures in check, so proponents of more aggressive corporate reforms could amp up their efforts using a different approach going forward. Support grew for resolutions seeking goals for greenhouse gas (GHG) emissions goals, though, as well as on other topics like methane leakage and deforestation. Despite high investor support for disclosure of GHG goals (35 percent on average this year), a new SEC no-action letter at **EOG Resources** this year suggests

[1] All voting results presented as shares cast in favor divided by those cast for and against, excluding abstentions and broker non-votes.

these resolutions may be blocked from investor consideration in the future, however—on the grounds that the request is too detailed and amounts to "ordinary business."

Political Activity

Investor support for political activity proposals continued its upward climb, too, although these proposals have yet to attract support from the big mutual funds. While some shareholder proponents of these resolutions feared SEC Staff Legal Bulletin 14I from late 2017 might knock out some proposals, and several companies argued vigorously that the bulletin supported omitting proposals on the grounds they are not significantly related to their underlying businesses, the SEC turned back these corporate requests, noting previous significant levels of investor support of more than 20 percent.

Diversity

Proposals seeking fair treatment and equal pay for women and people of color, combined with those seeking more diverse boards of directors, made up the third main theme of proxy season this year. Three of the high votes (above 40 percent) were for equal employment opportunity proposals and proponents ended up withdrawing most of the 34 board diversity resolutions after companies agreed to change their nominating procedures to provide greater consideration of more diverse slates of board candidates.

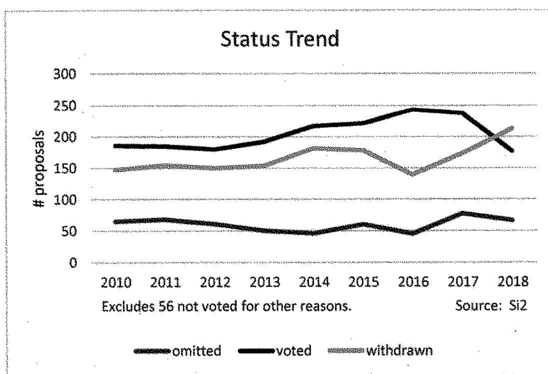
New Issues

In addition to the new gun safety and opioid proposals noted above, a key development in 2018 was a raft of about two dozen proposals asking for links between executive compensation and a range of social and sustainability issues. Proposed links between drug pricing, business risks and pay notably attracted support in the 20-percent range, for the first time.

Key Metrics

Volume

The total number of shareholder resolutions filed in 2018 about the environment, social issues and sustainable governance[2] dropped to 464, as noted, down from last year's record of 494, but have risen some over the last decade. Social issues continued to dominate, sustained by continued interest in political activity, decent work and workplace diversity—in addition to human rights and a few more topics. Environmental proposals have remained relatively constant over time but have fallen slightly in the last two years, while



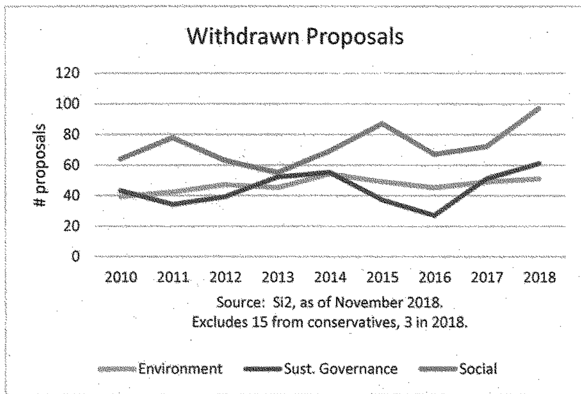
[2] "Sustainable governance" is defined as proposals that seek changes in a company's corporate governance related to social, environment or sustainability subjects—dealing with reporting, boards or executive compensation.

sustainable governance resolutions continue to increase. Additionally, filings from political conservatives have stood at a relatively constant low level and dropped a bit in the last three years. *(Graph, p. 1.)*

Withdrawn proposals (212) exceeded the number voted on (177) for the first time ever. Omissions fell to 66 from 77 last year. The number voted is down from 237 last year and is the lowest of the decade. *(Graph, bottom of previous page.)*

Withdrawals

The increase in withdrawals came at least in part because of some strategic retreats by proponents who judged they would lose company challenges and withdrew before any SEC response to company arguments. But investors also struck deals as company agreed to act, on a host of issues, as in the past.



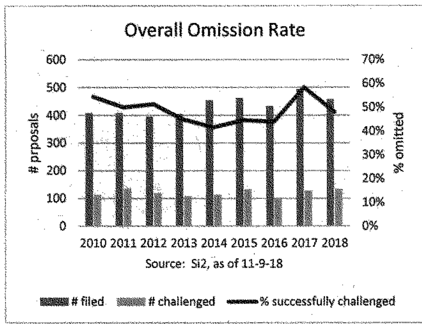
There was a marked jump in withdrawn proposals about social issues. *(Graph right).* On particular topics, social issues withdrawals rose notably for *gender pay equity* (26 withdrawn, up from 16 last year), *EEO reporting* (17, up from seven) and *political activity* (23, up from 18). For the environment, withdrawals have risen overall but did not grow dramatically—although they did for *carbon asset risk reporting* (16, up from nine). On sustainable governance, there were lots of withdrawals on *board diversity* (29, up from 25) and *sustainability reporting* (20, up from 15).

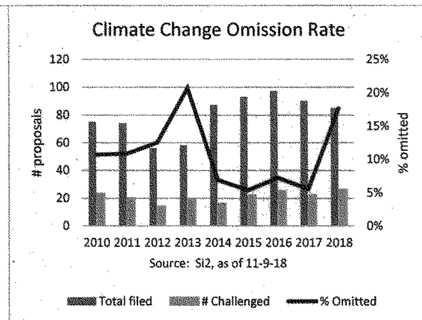
Climate Change Proposals Omitted in 2018

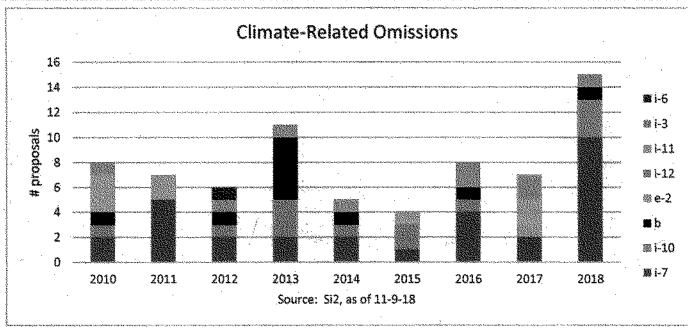
Reason	Proposal	Company
i-7	Adopt GHG reduction targets	EOG Resources
	Report on net-zero GHG goals	Amazon.com Apple Deere PayPal Verizon
	Report on oil sands financing	JPMorgan Chase
	Report on renewable energy goals	Gilead Sciences Red Hat Rite Aid
i-10	Report on changed carbon asset mix	Exxon Mobil
	Report on energy efficiency efforts	Apple
	Report on stranded carbon assets	PNM Resources
i-12	Report on renewable energy goals	Ameren
See next page for explanation of omission reasons under Rule 14a-8.		

Omissions

The rate of omitted proposals dropped, despite the new legal bulletin. But the omission rate for climate change proposals rose sharply this year, driven by omissions on Rule 14a-8(i)(7), "ordinary business." This reason was used in 2018 more than it ever has been in the past. *(Graphs, next page.)*





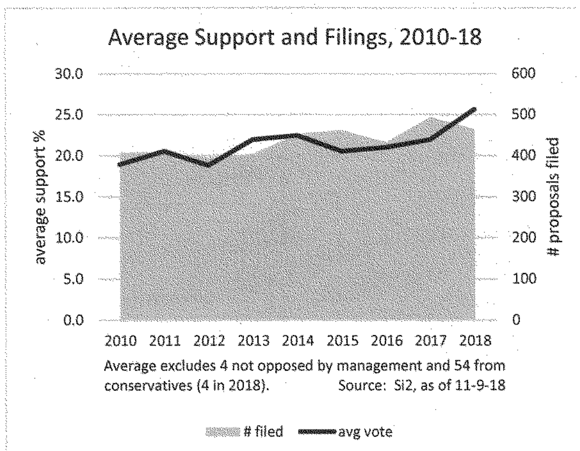


Rule 14a-8 Provisions		Explanation
Substantive Reasons	i-3	False/misleading or too vague
	i-6	Cannot be implemented by the company
	i-7	Relates to ordinary business
	i-10	Moot
	i-11	Duplicates a similar proposal
	i-12	Previous similar proposal missed refiling threshold
Technical Reasons	b	Proponent failed to prove stock ownership
	e-2	Filed too late

Note that high number of climate-related omissions in 2013 occurred because of technical filing problems, not a substantive policy shift in SEC reasoning, as occurred in 2018.

Support

Average support has risen to an all-time high of 25.1 percent, up from 21.4 percent in 2017. *(Graph right.)* In the last three years, 28 resolutions have earned majority support; 49 have done so since 2010. Support is highest for climate change sustainability reporting resolutions, as well as those seeking disclosure of political activity and diversity data.



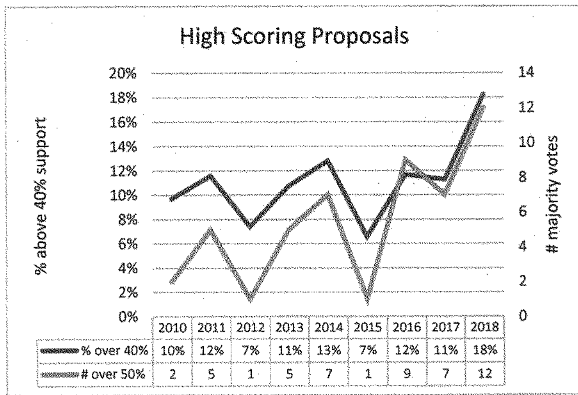
High scoring proposals: In addition to the 12 majority votes in 2018, another 19 earned between 40 percent and 49 percent *(table below)* and 35 more earned between 30 and 39 percent. Strikingly, all but one of the resolutions that earned the highest support dealt with new issues of intense public debate—gun safety (**American Outdoor Brands** and **Sturm, Ruger**) and the opioid crisis (Depomed, now called **Assertio**, and **AmerisourceBergen**). Like last year, more of the top-scorers related in some way to the environment and sustainability (15) than any other categories; six more concerned election spending or lobbying. Three were about equal employment opportunity and one concerned student loans.

High Scoring 2018 Resolutions

Company	Proposal	Proponent	Vote (%)
Rite Aid	Publish sustainability report ×	Sisters of St. Francis, Phila.	80.0
Sturm, Ruger	Report on gun safety and harm mitigation	Catholic Health Initiatives	68.8
Depomed (now Assertio)	Report on opioid crisis	UAW Retirees	62.3
Rite Aid	Report on opioid crisis	UAW Ret. Med. Benefits Trust	61.4
Kinder Morgan	Publish sustainability report	NYSCRF	60.4 ↺
Kinder Morgan	Report on 2-degree analysis and strategy	Zevin Asset Management	59.7 ↺
Genesee & Wyoming	Adopt GHG reduction targets	Calvert Investments	57.2
Middleby	Publish sustainability report	Trillium Asset Management	57.2 × ↺
Ameren	Report on coal ash risks	Sch. Srs. N. Dame, Ctl Pacific	53.2 ↺
Anadarko Petroleum	Report on 2-degree analysis and strategy	As You Sow	53.0*
American Outdoor Brands	Report on gun safety and harm mitigation	Srs. of the Holy Names	52.2
Range Resources	Report on methane emissions/ targets	Unitarian Universalists	50.3
Acuity Brands	Publish sustainability report	Trillium Asset Management	49.8
Old Republic International	Adopt board oversight of climate change	Pax World Funds	48.6
American Financial Group	Publish sustainability report	NYSCRF	48.4
Home Depot	Report on EEO and affirmative action	Benedictine Srs., Boerne - TX	48.3 ↺
Allstate	Review/report on election spending	Teamsters	46.5 ↺
Noble Energy	Report on 2-degree analysis and strategy	Presbyterian Church (USA)	45.7 ↺
CMS Energy	Review/report on election spending	NYSCRF	45.2 ↺
Chevron	Report on methane emissions/ targets	Park Foundation	45.0 ×
Juniper Networks	Disclose EEO-1 data	NYC pension funds	43.9 ↺

High Scoring 2018 Resolutions			
Company	**Proposal**	**Proponent**	**Vote (%)**
Applied Materials	Disclose EEO-1 data	NYC pension funds	43.8
NextEra Energy	Review/report on election spending	NYSCRF	43.2 × ↺
Sanderson Farms	Phase out antibiotic use in animal feed	As You Sow	43.1 ↺
Navient	Report on student loans	Rhode Island Pension Fund	42.8 ! #
Wyndham Worldwide	Review/report on election spending	Mercy Investments	42.8 ↺
Fluor	Adopt GHG reduction targets	NYSCRF	41.6 ↺
AmerisourceBergen	Report on opioid crisis	Srs. of St. Francis of Phila.	41.2 ×
Honeywell International	Report on lobbying	Azzad Asset Management	40.7 ↺
American Water Works	Report on lobbying	Boston CAM	40.3
Darden Restaurants	Report on antibiotic use in animal feed	Green Century Funds	40.2

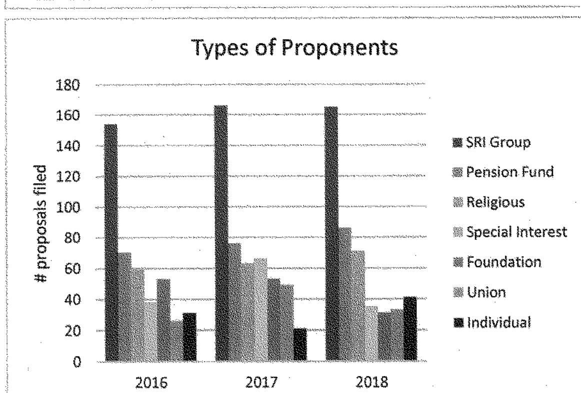
↺ Resubmission *Same proposal withdrawn in 2017 #Similar proposal omitted in 2017
× SEC challenge rejected ! SEC challenge lodged but not resolved before proxy issued



As the graph at right shows, the proportion of majority votes and high-scoring resolutions is climbing.

Proponents

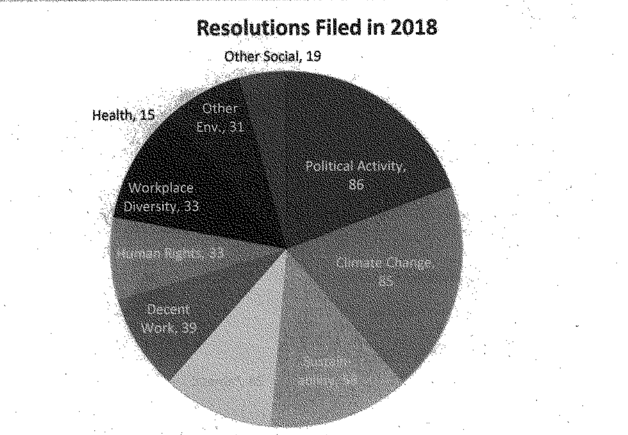
A wide range of institutional investors, as well as some retail investors, file the shareholder proposals discussed in this report. SRI firms are by far the most likely to file resolutions, followed by pension funds and religious groups. A few single-issue special interest groups also file, and some foundations. Unions are relatively uncommon proponents, while filings from individuals have risen a bit. *(Graph right.)*



Many proponents co-file with each other and resolutions are classified here by the lead filer's institution type; this classification particularly undercounts activity by members of the Interfaith Center on Corporate Responsibility (ICCR), whose members often co-file.

2018 RESULTS

This section provides a look at the main issues raised in each of the topics raised during the proxy season, highlighting new issues, continued big campaign and significant results, with special attention to the ways in which SEC Staff Legal Bulletin 14I from November 2017 shaped the proxy season, as discussed above in the Overview. As of November, just three more were awaiting votes at Oracle's annual meeting on Nov. 14.



**includes 34 on board diversity. Pie also includes 18 proposals from conservative groups.*

Environmental Issues

Climate change remains the dominant topic for environmental proposals; it also continues to undergird many other corners of shareholder activity.

Climate Change

Out of the 85 resolutions on climate, three-quarters raised requests that have been around for a long time, seeking more information about how companies report and manage carbon asset risks and set goals to reduce their greenhouse gas (GHG) emissions, in both conventional and unconventional oil and gas operations.

Carbon Asset Risk

A core request was for companies to explain how they will adapt to a scenario with a low-carbon economy that prevents a global temperature increase above 2 degrees Celsius, as agreed in the Paris Climate Treaty. Most of the 28 recipients were energy and utility companies that routinely get these requests in some form.

Only six of 22 scenario proposals went to votes, producing two majority votes—53 percent at **Anadarko Petroleum**, where it had not been considered previously, and 59.7 percent at **Kinder Morgan** (up from 38.2 percent last year). Another high vote was at **Noble Energy**—45.7 percent (up from 24 percent last year). Proponents withdrew 14 after companies agreed to report. The reports from companies so far do not appear to signal any energy sector plans for radical business model shifts and have for the most part reiterated the industry's view that exploration and production of oil and gas can continue given demand, despite the climate change consequences. Investors are faced with growing questions about whether to continue efforts to reform these companies or to abandon this quest, even as money center investment analysts refine their models that quantify the risks. Illustrating a possible shift, As You Sow released a new report on Sept. 6, *2020: A Clear Vision for Paris Compliant Shareholder Engagement*. It expresses dissatisfaction with the results of shareholder resolution work on climate change at energy companies, concluding, "Shareholders must grapple head-on with the implications of an oil & gas business model that continues to invest unabated in products which, when used, run counter to science-based targets and the Paris Agreement." But Climate Action 100+, a five-year international initiative backed by Ceres and investors globally with $32 trillion in assets under management remains committed to engagement with the world's biggest GHG producing companies; members will continue to press for disclosures in line with the recommendations of the Task Force on Climate-related Disclosure.

At **Ameren**, investors signaled growing insistence that the company should report on coal ash risks, increasing the vote to a 53.2 percent majority, up from 46.4 percent last year. Coal ash disposal remains a challenge for the utility industry and was in the news after flooding from hurricane Florence in North Carolina during 2017 caused ponds from Duke Energy to overflow; the ash ponds stayed intact during hurricane Michael in 2018, however.

Greenhouse Gas Emissions

On emissions management, there were another 27 proposals. The seven votes on a longstanding request to set quantitative, time-bound reduction goals included a 57.2 percent majority at the railroad company **Genesee & Wyoming**, as well as 41.6 percent at **Fluor** (up from 36.7 percent last year). Five other votes were all above 20 percent. Seven of the targeted companies agreed to set goals, prompting withdrawals.

In what was probably the most consequential SEC action of the year on shareholder resolutions, commission staff agreed with **EOG Resources** that it could omit one of these quantitative goal proposals on ordinary business grounds, agreeing for the first time that this constitutes micromanagement—citing the new SEC staff legal bulletin from November. Investors have voted on this resolution 70 times since 2010, with average support increasing from 24 percent in 2010 to 35 percent this year; there have been 129 such proposals filed, with 51 withdrawals.

Eight resolutions also asked companies to report on more stringent net-zero GHG goals, but there was just one vote—of 32.8 percent at **Cooper Companies**—because the SEC agreed with other company challenges that this goal was too specific and constituted micromanagement and that the resolutions were excludable as noted above.

As You Sow had a new resolution requesting a report from **Ford Motor** and **General Motors** about auto emissions regulations and a decarbonized vehicle market. It survived an SEC challenge by GM and earned 26.9 percent there, twice the 12.8 percent tally at Ford where votes are always low given family control of a large swath of the stock.

Unconventional Fossil Energy

Methane was the primary concern of 12 resolutions about unconventional oil and gas operations and how they detect and reduce leaks. Support for this issue is strong and included a 50.3 percent majority vote at **Range Resources**, as well as 45 percent at **Chevron**. Companies and investors are able to find common ground on the subject and reached six withdrawal agreements. (A key reference on this issue is the Disclosing the Facts series of reports, which in its December 2017 iteration focused on methane specifically.)

Renewable Energy

Proponents simply want to see more renewable energy use and more attention to energy efficiency; there were 15 resolutions at utilities, communications companies, retailers and others seeking goals. Three companies prevailed at the SEC with arguments that these resolutions are excludable on micromanagement grounds because energy costs account for only a small part of their expenses. Similar challenges prompted two of the five withdrawals, but three withdrawals were at companies that reported they are using more renewables. The highest vote was 31.3 percent at **Kroger.** Otherwise, a resubmitted proposal on distributed energy (employing, for instance, rooftop solar panels) at **Entergy** earned 30 percent, down from 35 percent last year.

Forests

NYSCRF persuaded **US Foods Holding** to address deforestation in its commodities supply chain and also reached an agreement with **Bunge**, the world's biggest palm oil firm, about reporting on deforestation concerns. The sole vote was 30.6 percent at **Domino's**, where it earned 23.1 percent last year. These resolutions raised human rights issues, as well.

Environmental Management

These 17 proposals dealt mainly with recycling and water.

Recycling and Waste

As You Sow scored a major victory when **McDonald's** agreed to eliminate Styrofoam from its packaging, prompting a withdrawal, and putting the pressure on others, although investors gave just 7.8 percent to a new proposal at the company from a different proponent about plastic straws, a new concern. As You Sow's recycled packaging campaign continued and won three votes around 30 percent at **Mondelez International, Starbucks** and **Kroger**, but less (13.5 percent) at **Kraft Heinz**. The group is emphasizing the impact discarded plastic has on growing ocean pollution. On Oct. 9, 2018, Mondelez announced it would make all its packaging recyclable by 2015, in a major development on this issue.

Another important angle raised in the new legal bulletin—whether a resolution must be "significantly related" to a company's business to be included on the proxy statement—came up at **Dunkin' Brands**. Although last year the SEC disagreed with the company's argument that a resolution on K-Cups could be omitted, this year it reversed course and said the same proposal didn't meet the "significantly related" standard (Rule 14a-8 (i)(6)). Proponents are concerned that going forward they may have to explain, in company-by-company fights, why resolutions should be included despite this provision, since it also allows for the inclusion of proposals that raise significant matters of public policy.

Water

Investor support for water resolutions was unspectacular, although a resubmitted proposal to **Tyson Foods** about the impact on water by farming operations for the company earned 15.8 percent, a high vote at the closely held company, up slightly from last year.

Nuclear Power and Bhopal

Shareholders gave modest support of 5.8 percent to a proposal at asking **DTE Energy** to explain the economic impact of an early closure of its controversial Fermi 2 nuclear plant, after it survived an SEC challenge. But a proposal from Amnesty International about the 1984 Bhopal industrial disaster's potential impact on the modern-day operations of **DowDupont** in India was blocked on ordinary business grounds.

Industrial Agriculture

Antibiotics

Chicken producer **Sanderson Farms** still disputes that antibiotics in animal feed have a negative impact on human health and investors increased their support for phasing out antibiotics to 43.1 percent, up from 31.5 percent last year. A similar proposal at **Darden Restaurants** received 40.2 percent. **McDonald's** said it will announce a policy about antibiotics in its beef supply chain by the end of the year, adding to its current ban for chickens, prompting the Benedictine Sisters of Boerne, Texas, to withdraw.

Pesticides

Tractor Supply agreed to conduct a risk assessment and remove all products with neonicotinoids that are proven to harm pollinator health, prompting Trillium Asset Management to withdraw its proposal in a continuing campaign on the issue. A resolution on protecting pollinators by cutting pesticide use in the **General Mills** supply chain earned 31.3 percent.

Animal in Products

There was just one vote on ensuring animal welfare in food and product supply chains—9.4 percent at **Luby's,** about cruelty prevention in chicken production. (The company is struggling and runs cafeterias—mostly in Texas—and the Fuddruckers hamburger chain with national locations; it provides no information on animal and little about its supply chain in general).

On a related front, People for the Ethical Treatment of Animals (PETA) withdrew its proposal to **VF** about eliminating all animal-derived products, including down, wool and leather, after the company announced it will ban the use of fur, angora and exotic skins in its products. The company had lodged an SEC challenge. **RH** successfully argued a PETA proposal to stop using down was ordinary business since it was specific to a product type. There were no other votes.

Social Issues

Animal Welfare

Just one of five resolutions on the ethics of using laboratory animals, selling glue traps or breeding orcas, from PETA, went to a vote. It was a lab animal reporting proposal at **Eli Lilly** and earned 3.2 percent.

Corporate Political Activity

The overall tally of resolutions about political influence spending reached 86 this year, down from a high of 136 in 2014 and 91 last year. Forty-seven were on lobbying, 28 continued the Center for Political Accountability disclosure and oversight campaign about election spending, three asked about both lobbying and election spending, and a few others raised other corporate political involvement questions.

The enduring sticking point remains disclosure of spending of company contributions disbursed through intermediary groups like trade groups and other non-profits that companies belong to. These and other groups that may legally shield the identity of their donors are major sources of "dark money" that heavily influences elections. In what appears to be a victory for disclosure advocates, a mid-September Supreme Court decision let stand a lower court ruling that requires political non-profits to disclose donors for their ads.

Critical SEC Questions

When the proxy season started, it was unclear whether companies would be able to use the new legal bulletin to redefine the "significantly related" portion of the shareholder proposal rule when it came to political activity proposals. **Alliant Energy, Citigroup, Eli Lilly** and **Goldman Sachs** all unsuccessfully argued their political expenditures were insignificant to the companies, with some also saying that investors are just not interested in the disclosure sought by proponents. (**Travelers** made the same argument, but the proponents withdrew before any response.) The SEC demurred, which relieved proponents, but in doing so it noted previous levels of support of 20 percent or more. This then prompted proponents to wonder if the commission was trying to signal its support for higher resubmission thresholds—which for more than 50 years have required that first year proposals earn at least 3 percent to qualify for resubmission, 6 percent the second year and 10 percent in each year thereafter. Higher resubmission thresholds have been on the wish list of companies and industry groups for years and proponents are chary of any changes, worrying about opening a can of worms that could damage their ability to raise issues of concern through the shareholder resolution process.

Conservative Copy Cats

New this year were proposals from the free market activist group the National Center for Public Policy Research (NCPPR) that used precisely the same resolved clause as the one used in the main campaign on lobbying. In two instances, because they were filed first, these resolutions pre-empted proposals filed later from the disclosure advocates, on lobbying at **Duke Energy** and about election spending at **General Electric**, where the question turned on third-party spending groups. The NCPPR proposals went to votes in each case and while the presenters argued *against* disclosure in their support statement, investors appeared to vote on the basis of what was in the resolved clause and support levels were comparable to those filed by disclosure proponents—34.6 percent at Duke (33.3 percent last year) and 21.2 percent at GE (no previous election proposals but 28.6 percent on a traditional lobbying resolution in 2017).

Results

Among the 30 votes on *lobbying*, 22 were above 20 percent, with highs of 40.3 percent at **American Water Works** and 40.7 percent at **Honeywell International.** Eleven more were above 30 percent. Votes of less than 10 percent were at **Alphabet** and **Ford Motor** (where insiders hold large blocks of the stock), and at **Goldman Sachs** (where proxy advisor ISS recommended against). There were 13 agreements in which companies agreed to provide information and prompted withdrawals.

For *election spending* proposals, four votes stood out—all resubmissions where support rose from last year: 43.2 percent at **NextEra Energy** (up from 41.2 percent), 45.2 percent at **CMS Energy** (36.2 percent), 42.8 percent at **Wyndham Worldwide** (37.7 percent) and 46.5 percent at **Allstate** (24.9 percent). Six more votes were above 30 percent and just one was below 20—a 17.4 percent score at **Ford Motor.** Proponents reached fewer negotiated withdrawals than with lobbying, with just three companies agreeing to provide more information. Many companies have agreed to disclosure requests outside the shareholder resolution process, however, as the Center for Political Accountability documents; it says nearly 300 companies have agreed to disclosure of political spending.

Otherwise, the AFL-CIO continued to ask financial giants to ban the premature vesting of equity pay for employees who leave to work for the government, with *"government service golden parachutes."* Investors seem to like the idea and gave it votes that hit a high of 35.3 percent at **Citigroup**, in addition to two other votes above 20 percent. A new resolution seeking a cost-benefit analysis of election spending from NorthStar Asset Management earned less support—just 6.9 percent at **Intel**. Another resolution questioned **FedEx** discounts to NRA members, but was omitted on technical grounds.

Decent Work

Equal Pay

The #MeToo movement and its demand for equal treatment—and, implicitly, equal pay—underscored a continued surge of resolutions about gender pay equity, but not that many votes (only five, down from 13 last year), with the highest score for a repeat at **TJX** that earned 26.2 percent, up 10 points from last year. Fourteen of the 31 resolutions asking for a report on gender pay equity were resubmissions, including all five that went to votes. Companies and proponents found a lot of common ground and there were 23 withdrawals, with companies rushing to assert they will close the gap between pay for men and women. Arjuna Capital was a key player and negotiated agreements with four of the nation's five biggest banks—**Bank of America, Bank of New York Mellon, Citigroup** and **Wells Fargo**—to work on closing the pay gap. Other important proponents were Pax World Funds and the New York City pension funds, led by the city comptroller's office. Most resolutions focused on women, but some also raised differential pay rates for people of color. SEC challenges were few.

Family Leave

Zevin Asset Management and an individual at **Walmart** filed four new resolutions on family leave but withdrew all of them after companies expanded their benefits. The proponents highlighted more generous leave policies for corporate staff compared with lower level employees and said this was discriminatory.

Diversity in the Workplace

Bookending the equal pay proposals were 25 about equal employment opportunity for women and people of color, plus another eight advocating for LGBT rights. Votes rose over last year's tallies for resolutions asking for the disclosure of gender, race and ethnicity by job category, with the highest 43.8 percent at **Applied Materials**, 43.8 percent at **Juniper Networks** and 48.3 percent at **Home Depot** (where it went to a vote for an unprecedented 17th time and earned its highest support to date). Most of the proposals also asked what companies are doing to increase diversity at work. There were 15 withdrawals after company commitments.

Zevin Asset Management withdrew after a challenge by **Amazon.com** to its resolution about the potentially discriminatory use of background checks in hiring; it got 7.3 percent last year but the challenge this year said current related litigation might make it excludable. Doubling down on its decision at **Cato** from last year, the SEC reaffirmed its view that the company need not explicitly include gay rights in its policy to protect LGBTQ employees; a gay rights proposal therefore was again omitted on the grounds it was moot.

Ethical Finance

Five proposals raised ethics issues—about lending at **Wells Fargo**, student loans at **Navient**, alleged discrimination in auto financing at **Santander Consumer USA** and tax fairness at **Facebook** and **NIKE**. Most popular with investors was the request at Navient, which received 42.8 percent when it asked how the company is managing its reputational and financial risks connected to the student loan crisis. Least popular was the tax proposal at Facebook, which got 1.4 percent. The auto lending resolution got 12.9 percent.

Health

New proposals came from the Investors for Opioid Accountability coalition, formed in summer 2017 with members that include state treasurers from hard-hit opioid epidemic states, faith-based investors and the UAW Retiree Medical Benefits Trust. Resolutions from the coalition used a corporate governance lens, looking at board oversight and pay clawback questions, but also issues of potentially undue political influence; they survived several SEC challenges. Shareholders gave unprecedented 62.3 percent support to a proposal asking for a report on **Depomed's** response to the crisis and its attendant risks; the also voted in similar fashion in support of this proposal at Rite Aid, giving it 61.4 percent. Depomed, which has changed its name to Assertio, has relied heavily on opioid sales, while Rite Aid is a key retail drug store where consumers fill opioid prescriptions. The proposal also earned 41.2 percent at **AmerisourceBergen**, a distributor, and NYSCRF withdrew it at **McKesson**, the country's biggest pharmaceutical distributor, after discussions.

Other votes on the risks of rising drug prices, tobacco and product links to obesity were 5 percent or less. A new resolution concerned about the negative impact of small airplane seats was omitted on ordinary business grounds. *(Separately, proposals also asked about executive pay links to drug pricing risks, as noted on p. 17.)*

Human Rights

In a big change from last year's human rights agenda, there were hardly any conflict zone proposals because the low-scoring Holy Land Principles campaign has been shelved.

Supply Chains, Risk Assessments, Trafficking

Proponents focused on perennial concerns about fair labor in supply chains, risk assessments and human trafficking, with the highest vote coming in at 19.9 percent at **Monster Beverage** on trafficking concerns in its commodities supply chain. Mercy Investments was particularly successful in reaching agreements with companies and negotiated six accords on its own. NYSCRF also pressed **Tesla** to respond to concerns about alleged workplace discrimination, sexual harassment and injuries; it withdrew after discussions.

Indigenous Peoples

The two votes for indigenous peoples' resolutions at financial companies were less than 6 percent (**Citigroup** and **PayPal**) and companies won two omissions on the grounds their current policies were sufficient. The proposals referenced the Dakota Access Pipeline cancelled by President Obama that was resuscitated by President Trump early in his term.

Weapons

ICCR members scored major victories with majority votes. The first—68.8 percent at **Sturm, Ruger**—came not long after a bloody start to the year with many school shootings and the massacre in Parkland, Florida on Valentine's Day. Retailer **Dick's Sporting Goods** responded to a proposal about gun safety and harm mitigation by pledging to end assault weapons sales, handing the proponents another victory. The Sturm, Ruger proposal earned at 52.2 percent **American Outdoor Brands** (the former Smith & Wesson). What did not go to a vote was a new resolution about insurance for gun owners, which had been underwritten until recently by **Chubb.** The company successfully argued the proponent did not prove his stock ownership, but the company also has stopped supporting CarryGuard, which had been sponsored by the National Rifle Association; critics have called it "murder insurance."

Conflict Zones

Two proposals about connections to genocide and one about operations in conflict zones earned votes of 5 percent to 8 percent at **Chevron, First Solar** and **JPMorgan Chase**—having survived challenges—but

Apple won approval from the SEC to omit the only Holy Land Principles resolution on the grounds that its policy made the proposal moot.

Media

NYSCRF won 35.7 percent support for a new resolution at **Twitter** that asked about how it is managing the content of its social media platform, but two others from Arjuna Capital earned less—12.8 percent at **Alphabet** and 10.2 percent at **Facebook**. The concept of shareholder involvement in this area earned praise from British Prime Minister Theresa May at the Davos summit in January.

In another corner of the cyber world, the UAW Retirees' Medical Benefits Trust withdrew a proposal about cybersecurity policies at hacked credit reporting company **Equifax**, while NYSCRF earned 29.5 percent for a similar risk mitigation report from prescription manager **Express Scripts**; the SEC rejected a company challenge of the latter proposal. *(Cybersecurity also came up in a proposal asking* ***Verizon*** *to link it to executive pay; see p. 17).*

Sustainable Governance

Board Diversity

Investors reached agreements with almost all the 34 companies they approached about board diversity, withdrawing all but four. About half the proposals asked companies to adopt policies that would encourage more women and minority board member candidates; the other half asked for reports on how they are pursuing greater diversity. All but a resubmission to **Pilgrim's Pride** were at new targets.

The policy adoption proposal earned 33.2 percent at **Discovery** and 24.8 percent at **First Hawaiian**, while reporting resolutions earned less: A new variant from the New York City pension funds asked six companies for proxy statement reporting in a matrix format that would show diversity attributes alongside other qualifications; it earned 16.5 percent at **ExxonMobil** after surviving an SEC challenge. The repeat reporting proposal at **Pilgrim's Pride** was from Oxfam America and it got a comparable result—15.4 percent. *(A conservative copy of the New York City proposal with an opposing premise went to a vote at* ***Alphabet*** *but earned almost no support.)*

Board Oversight

Eight proposals asked for specific types of board oversight, regarding human rights, climate change or sustainability more generally. The highest vote here was at **Old Republic International** for a resolution filed by Pax World Funds on climate change oversight; it received 48.6 percent support. Old Republic is an insurer and asserts it faces minimal climate risk; it does not address climate change-related risks in its securities filings. The other four votes were much lower.

There were three votes on resolutions seeking specific types of board experts. The long-running NYSCRF resolution at **Chevron** earned 26.5 percent this year, up from just under 20 percent in 2017. Proposals requesting appointment of human rights experts earned much less—just 4.9 percent at **Caterpillar** and 10.4 percent at **Motorola Solutions.**

Sustainability Oversight and Disclosure

Sustainability Reporting

The number of proposals seeking sustainability reports rose in 2018 to 31 after having fallen from a high of 45 in 2014. Investors increasingly insist on voluntary corporate sustainability disclosures and companies that do not provide it stand out—and are called out by investors. The resolutions asked for public reporting on a range of environmental and social issues; 11 specified they wanted GHG goals reporting.

The highest vote for the year (out of a total of nine) came at the end of October, when investors disenchanted with **Rite Aid's** two failed merger attempts gave unprecedented 80 percent support for a sustainability disclosure resolution. Two repeat resolutions also saw previous high votes become majorities, with a 57.2 percent tally at **Middleby** (up from 44.6 percent in 2017) and 60.4 percent at **Kinder Morgan** (38.5 percent last year). Other high votes were near majorities of 49.8 percent at **Acuity Brands** (a new target) and 48.4 percent at **American Financial Group** (also new). Votes at **Host Hotels & Resorts** and **XPO Logistics** were above 30 percent. Proponents withdrew 17 resolutions after agreements that promise new reports and more dialogue.

In additional to more standard sustainability reporting requests, this year there were two new, specific reporting resolutions, but neither went to a vote. The AFL-CIO wanted **Amazon** to report on the societal impacts of its business model while an individual wanted **DTE Energy** to report on the financial impact of its environmental record. Both were omitted on ordinary business grounds.

ESG Pay Links

In a big increase, a total of 22 resolutions asked for reports on links between a variety of issues and executive compensation, reflecting many of the subjects raised in proxy season—executive diversity, drug pricing strategies, sustainability in general, cybersecurity, fossil fuel reserves accounting and risky financial practices. Most were at new targets. Notably, all those asking for ties to *drug pricing strategies* survived SEC challenges and went to votes—with four of the five resulting votes over 20 percent. The record was more mixed on other sustainability tie requests—with four withdrawals, four votes and one omission on technical grounds. Just one of six of the executive diversity proposals went to a vote, earning 8.7 percent at **Alphabet**. At **Verizon**, investors gave 11.6 percent support to a new proposal seeking an executive pay tie to cybersecurity risk, about which the SEC issued updated company guidance in February 2018. The company had tried unsuccessfully to omit it on ordinary business grounds.

Proxy Voting

One of the four proposals seeking reports about proxy voting at mutual funds companies went to a vote, receiving 6.8 percent at **Bank of New York Mellon.** Three others were withdrawn. BlackRock's expanded slate of social and environmental concerns to be reflected in new proxy voting practices forms the backdrop for these resolutions that is establishing a new norm that has had a clear impact on voting results and the balance of power in shareholder resolution voting.

Conservatives

Continuing their efforts to persuade investors of the merits of a free market approach, political conservatives filed a range of proposals—mostly on social issues. An effort to get companies to report on their free speech policies struck out at the SEC, omitted on ordinary business grounds, while one in a similar vein at **Salesforce.com**, calling out the company for its support for gay rights, earned 1.1 percent and missed the resubmission threshold.

Most successful for the National Center for Public Policy Research, the primary filer of these sorts of resolutions, were those that praised corporate support for the American Legislative Exchange Council at **Duke Energy** and **General Electric**. As noted above in the section on political contributions, because of the wording of the resolved clauses, these proposals earned votes above 20 percent, comparable to pro-disclosure proposals even though their sponsors favor corporate involvement in the political arena—but not disclosure about spending on such endeavors.

Proposals that ask media companies to "tell the truth" were omitted, as in the past, while individual Steven Milloy withdrew at **ExxonMobil** after asking it to provide a cost-benefit analysis of its sustainability policies.

The copy-cat technique in play for lobbying discussed above also appeared in two resolutions on board diversity that emulated the New York City "matrix" reporting resolution; the proponent said he introduced it at **Facebook** only to "satiate liberal bean counters," but he failed to prove his stock ownership. It earned 2 percent at **Alphabet** and cannot be considered again for three years.

About Si2

The Sustainable Investments Institute (Si2) is a non-profit organization which helps its institutional investor subscribers make informed, independent voting decisions on social and environmental shareholder proposals with impartial reports that do not take a position. Si2 also researches related efforts to influence corporate policies, explaining what investor reformers want and how companies respond. Primary support comes from annual fees paid by the largest U.S. college and university endowments and some of the largest North American pension funds. Si2 also has received significant grants from the Investor Responsibility Research Center Institute.

For this report, Si2 is grateful for the generous cooperation of shareholder proponents, especially for their explanations about what happened when resolutions did not go to votes. Such information provides a critical measure of shareholder "success" from the proponents' perspective, but negotiations often occur in private. This report aims to provide a compilation of all shareholder activism about social and environmental issues for the record, alongside the more visible votes and efforts by companies to challenge the admissibility of proposals at the SEC.

Valuable editing from Carolyn Mathiasen improved this report. Si2's research director, Robin Young, provided key research assistance.

Contacting Si2: Please call or email us if you have any questions:

			Office	Mobile
Heidi Welsh	Executive Director	heidi@siinstitute.org	301-432-4721	240-625-2975
Robin Young	Research Director	robin@siinstitute.org	301-557-9273	703-819-4129

Si2 Sustainable Investments Institute

December 5, 2018

The Honorable Michael Crapo, Chair
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs
U.S. Senate
Washington, DC 20510

Re: Hearing on the Proxy Process December 6, 2018

Dear Chairman Crapo and Ranking Member Brown:

I'm writing to provide comments to your committee for consideration in conjunction with your scheduled December 6 hearing on the shareholder resolution process and rules. These comments reiterate and expand on a comment I submitted to the Securities and Exchange Commission Staff Roundtable on the Proxy Process, File No. 4-725, held on November 15, 2018.

This letter submits information about trends in shareholder resolutions filed by investors on social, environmental and sustainability issues, including information about the volume of these filings and their ultimate disposition since good policy flows from an accurate assessment of the activity being regulated. Also included are conclusions from new research about corporate disclosure about sustainability issues, many of which are raised in disclosure requests in shareholder resolutions, since this signals how companies are responding to investor requests. Finally, I include important information about an oft-cited source of proxy season activity which has some procedural flaws, about which the Senate should be aware.

The Sustainable Investments Institute (Si2) is an impartial, nonprofit organization that researches and analyzes information about U.S. shareholder proposals for leading North American institutional investors, including the largest endowed U.S. colleges and universities and several large public pension funds, among others, who collectively manage assets of more than $1 trillion. While we closely follow these proposals and the issues they raise to inform our subscribers, we do not provide voting recommendations. We also publish benchmarking reports analyzing how and why large public companies respond to reform pressures from their investors and other stakeholders—matters that often are raised in shareholder resolutions. Our reports on the filings and fate of shareholder proposals illustrate the extent to which these issues have traction with investors at large, while the benchmarking reports provide a sense of how much traction the issues have with corporations.

1. Proxy season provides a signal of investor sentiment

Shareholder proposals clearly serve as a useful barometer of the full spectrum of engagement between investors and their investee companies on key current and long-term issues of market and public policy concern. Our research about company behavior on key proxy season topics has documented how many corporations have responded to their shareholders' requests by changing their behavior. (Reports available at https://siinstitute.org/reports.html). For instance, on three major themes we have tracked over the course of this decade—climate change, corporate political activity disclosure, and diversity—companies increasingly are reporting on greenhouse gas emissions and climate change risk planning, disclosing more about political expenditures, and making efforts to diversify their boards and workplaces. While shareholder resolutions are filed by investors with a particular viewpoint, the levels of support for these proposals from investors at large helps companies evaluate their options for responding most effectively. The increasing number of negotiated withdrawals of proposals, in which companies and proponents agree, illustrates how this private ordering process identifies common ground and good ideas.

While some suggest that the shareholder proposal process has run amok and raises issues irrelevant to investors and companies, this does not in general appear to be the case from our perspective. What is clear is that shareholder proponents do present companies and fellow investors with a wide range of ideas about how to respond to important issues that affect the market and corporate fortunes. Investors at large are free to vote against resolutions that they do not support—and do. The key question the committee and the Securities and Exchange Commission should consider in evaluating any proposal that would further limit proponents and proposals is why less information and fewer ideas will make for better functioning capital markets.

Attached here is a report that examines shareholder proposal filings on social, environmental and sustainability issues, with trends since 2010 and details about the issues considered in 2018. It highlights a recent reduction in the number of proposals going to votes on these issues and an increase in withdrawals. It also illustrates the jump in the number of climate change omissions in 2018 that came after a shift in SEC staff interpretation of Rule 14a-8 following Staff Legal Bulletin 14I in November 2017. Most importantly, however, it documents a broadening of investor support for more corporate disclosure, with environmental and sustainability concerns topping the list.

2. Corporate reporting provides a key signal about the materiality of sustainability

As noted above, another key matter for the Senate to consider when examining the state of investor-company engagement (as expressed in shareholder resolutions) is the extent to which companies are agreeing to changes suggested in the proposals. Our recently released report, *The State of Sustainability and Integrated Reporting in the S&P 500*, establishes how often companies include quantified environmental, social and sustainability metrics and goals in their reporting to investors and other stakeholders. Findings from the report's analysis of 2018 securities filings include the following, based on an evaluation of corporate websites and filings in summer 2018:

- 78 percent of S&P 500 companies issue a sustainability report.
- 40 percent of S&P 500 companies include voluntary sustainability discussions in annual financial reports or other regulatory filings. This is a key signal that an increasing number of companies believe sustainability issues are financially material.
- Among companies that issue sustainability reports, 95 percent offer quantified, annually comparable environmental performance metrics; two-thirds set quantified and time-bound environmental goals (most often with respect to greenhouse gas emissions). Some 86 percent offer social performance metrics, but only 40 percent set quantified social goals.

The report, published with the support of the Investor Responsibility Research Center Institute, is available at https://irrcinstitute.org/reports/state-of-sustainability-and-integrated-reporting-2018/. It is appended to this submission.

3. Assessments of shareholder resolution activity

Finally, I urge the Banking Committee to carefully evaluate reports and assessments about shareholder resolutions to ensure that any action it decides to take with respect to the shareholder resolution process is based on a full picture of this investor-corporate engagement practice. An oft-cited source of information about shareholder resolutions is the Manhattan Institute's Proxy Monitor project (http://www.proxymonitor.org/Default.aspx), which periodically issues reports about its view on proxy season results. Proxy Monitor's assessment of the state of play has some procedural flaws that make its conclusions somewhat inaccurate, as I have noted in a September 16, 2013 post on the Harvard Law School Forum on Corporate Governance and Financial Regulation. The three key failings are:

1. **The data set has a large company bias.** It does not capture the increasing propensity of investors to file at companies *outside* the *Fortune* 250—missing a key trend of proxy season and developments outside the largest firms. This gives an inaccurate sense of the pace of filings. It also extrapolates to the whole corporate world the tendency of most of the very biggest companies to vigorously contest shareholder resolutions, with challenges to their admissibility using the Rule 14a-8 process on shareholder resolutions that ask for "no-action" letters from the SEC's Division of Corporation Finance. Such legal action incurs costs to companies they themselves choose, but this response to investor proposals is less common outside the very largest firms.
2. **Proxy Monitor undercounts withdrawn and omitted proposals, further limiting its picture of engagement.** To see the full picture of investor engagement with shareholder resolutions, one must identify all filings. This information is non-public unless a) a proponent provides publicity in a press release or other announcement, b) the resolution is challenged at the SEC with a no-action letter, or c) proponents independently confirm information about their filings to researchers. Si2 conducts the primary research needed to identify all filings, not just post-proxy statement numbers, which uncovers a much bigger universe of engagement than the one on display in Proxy Monitor data. This is relevant, for instance, in assessing the differential on specific issues of the proportion of withdrawn proposals to those filed, which shows where companies and proponents find common ground—a key fruit of shareholder engagement that can benefit all investors. For example, high proportions of resolutions seeking nondiscrimination policies for LGBTQ employees, board diversity policies and reporting, and sustainability reports get withdrawn—and are not counted at all by the Proxy Monitor assessments.

3. **Vote results reported by Proxy Monitor are inconsistent**. Each company determines the voting requirement for resolutions considered by investors; these requirements appear in corporate charters—and are a matter of state law. A company might, for instance, require variously-defined super majorities for some subjects voted on by investors and a simple majority for others, thus varying the denominator in reported votes and shifting the goal posts. Companies also sometimes report their voting results on shareholder resolutions by a) counting an abstention as "against" or b) counting votes that are not cast at all as "against" (these are known as "broker non-votes"). While it is clearly valid to note how a company counts its investors' votes, and what its requirements are, any defensible assessment of comparable trends must compare like with like. The SEC's Rule 14a-8 resubmission threshold requirements that are based on shares cast for and against, setting asides broker non-votes and abstentions, provides an obvious example of how to do the math, but this is not the approach taken by Proxy Monitor. As a result, Proxy Monitor reports are inconsistent and provide non-comparable data about investor assessments of issues raised at America's publicly traded companies.

A fuller discussion of Proxy Monitor's methodology from the Harvard blog post is appended to this letter and also can be found at https://corpgov.law.harvard.edu/2013/09/16/accuracy-in-proxy-monitoring-2/.

* * *

I am happy to respond to any questions about the data presented in the attached reports and can be reached at email heidi@siinstitute.org or telephone 301-432-4721.

Thank you for your consideration.

Sincerely,

Heidi Welsh

Heidi Welsh
Executive Director
Sustainable Investments Institute (Si2)

Attached: 2018 Si2 Proxy Season Review
The State of Sustainability and Integrated Reporting in the S&P 500
"Accuracy in Proxy Monitoring," Harvard Governance Forum post

TRILLIUM
ASSET MANAGEMENT®

December 3, 2018

The Honorable Michael Crapo, Chair
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

RE: Hearing on Proxy Process and Rules, December 6, 2018

Dear Chair Crapo and Ranking Member Brown,

On behalf of Trillium Asset Management, I respectfully submit the following comments for the record with regard to the Hearing on Proxy Process and Rules scheduled for December 6, 2018.

Trillium Asset Management is an employee-owned investment management firm with approximately $2.8 billion in assets under management. Trillium integrates Environmental, Social, and Governance (ESG) factors into the investment process as a way to seek to identify the companies best positioned to deliver strong long-term performance. We manage retirement savings for thousands of clients through mutual funds and individually managed accounts. For 35 years, many of our clients have been the small shareholders and retirement savers that the hearing, committee, and the Securities and Exchange Commission (SEC) seek to protect. Our clients are looking for advisors that integrate ESG factors and use advocacy and shareholder proposals to improve company ESG performance - it is an important part of why they invest in funds like ours. From this perspective, many of our clients are "main street investors."

Evidence shows that interest in ESG investing is growing. A 2017 survey conducted by BlackRock found that 67% of millennials want their investments to mirror their social and environmental values - and the figure for women was even higher, 76%.[1] And as we know 53 percent of women report they either have a "great deal of responsibility" or they "do it all," when managing the household's long-term savings and investments.[2]

---

[1] https://www.forbes.com/sites/michelegiddens/2018/07/05/demographic-trends-are-driving-demand-for-impact-investment-and-the-industry-is-starting-to-adapt/#21dbdbb14264
[2] http://solutions.naifa.org/majority-of-women-now-responsible-for-household-finances

Trillium has found that shareholder advocacy leads to positive interactions with companies. We find it to be a useful, cost effective, well understood method of private ordering on ESG issues. Often, Trillium functions as a catalyst to help *foster* change, rather than *force* change. It is important to note that it is very common for us to withdraw a proposal, and on numerous occasions have publicly received positive feedback or thanks from companies.[3]

It is also useful to recognize that shareholder proposals provide a useful information signal to many investors. In MFS Investment Management's comment letter to the SEC for the November 15, 2018 Roundtables on the proxy process, MFS pointed out that shareholder proposals and votes "can augment our understanding of the risks and opportunities inherent in the companies we own. As such, we would view any action to limit some shareholders' rights to file proposals as an action to limit all shareholders' ability to fully consider all risks and opportunities of their investment."[4]

Even the National Association of Manufacturers implicitly recognize that the vast majority of shareholder proposals speak to important issues and are not focused on narrow interests without regard for the business or long-term investor returns. As the organization put it in its SEC Roundtable comment letter, "the NAM believes strongly in the importance of managing the risk of climate change, ensuring clean air and water, increasing workplace diversity, and addressing many of the other issues often pursued by activists. Indeed, manufacturers have taken proactive steps to implement environmental, social, and governance (ESG) policies suitable for their business and their investors."[5]

It is also important to understand that shareholder proposals constitute a very small fraction of proxy activity at companies. The number of shareholder proposals per company has fallen over time and is currently the median number of proposals is one per year.[6] According to the Los Angeles County Employees Retirement Association's ("LACERA"), shareholder proposals

---

[3] http://www.trilliuminvest.com/akamai-commits-significant-renewable-energy-goals/; http://www.trilliuminvest.com/trillium-successfully-withdraws-board-diversity-proposal-at-wabtec-2/; http://www.trilliuminvest.com/trillium-successfully-withdraws-workforce-diversity-proposal-at-adobe/; http://www.trilliuminvest.com/nordstrom-commits-report-human-rights-risks-supply-chain/; http://ir.cambrex.com/phoenix.zhtml?c=80683&p=irol-newsArticle&ID=2343613; http://www.trilliuminvest.com/trillium-successfully-withdraws-board-diversity-shareholder-proposal-logmein/

[4] https://www.sec.gov/comments/4-725/4725-4645875-176484.pdf

[5] https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf

[6] https://www.cii.org/files/10_10_Shareholder_Proposal_FAQ(2).pdf

accounted for about 2% of the total proxy votes for LACERA in 2018, and about 3% in both 2017 and 2016.[7]

According to our analysis of ISS data[8], 13% of Russell 3000 companies received a proposal in any given year between 2004 and 2017, which means that on average a company should expect to receive a shareholder proposal once every 7.7 years. The Manhattan Institute reports that the number of shareholder proposals per company fell to 1.24 in 2017.[9] The ISS data also indicates that less than 4% of proposals were filed at companies with under $1 billion in market capitalization and that less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.

It is also evident that shareholder proposals are a low cost method of enabling private ordering in the capital markets. As a letter from the Council of Institutional Investors, Principles for Responsible Investment, US SIF, Interfaith Center for Corporate Responsibility, and the Investor Network on Climate Risk representing $65 trillion in assets to Gary Cohn, President Trump's first Director of the National Economic Council, explained "for over 45 years the shareholder proposal process has served as a cost effective way for corporate management and boards of directors to gain a better understanding of shareholder priorities and concerns and to benefit from those insights on critical and emerging risks and opportunities."[10]

Being able to offer precatory shareholder proposals provides investors with the ability to raise their concerns with company management, directors, and investors without dictating particular changes. Without this mechanism, shareholder will be left with crude and/or more drastic substitutes to express their concerns, such as binding bylaw changes, "vote no" campaigns against directors, and proxy access for director elections.

Dozens of investment firms representing trillions of dollars file shareholder proposals on ESG issues. From 2016 through the first half of 2018, 165 institutional investors and 54 investment managers collectively controlling nearly $1.8 trillion in assets at the start of 2018 filed or co-filed shareholder proposals on ESG issues.[11] One of the reasons for this is that hundreds of studies, from both the financial sector and academia, support with widely varied and empirical evidence the idea that sustainable investing performs comparably with, and often better than, mainstream investing on a risk-adjusted basis. For example, of the 20 equity indexes in Morningstar's Global Sustainability Index Family, sixteen have outperformed their non-ESG

---

[7] https://www.sec.gov/comments/4-725/4725-4587744-176291.pdf

[8] https://www.ciiref.org/resubmission-thresholds

[9] http://www.proxymonitor.org/Forms/pmr_15.aspx

[10] https://www.iccr.org/sites/default/files/resources_attachments/2017.03.15_letter_to_gary_cohn_-_14a-8_shareholder_proposal_process.pdf

[11] https://www.ussif.org/fastfacts

equivalent over their life span.[12] In fact, the ability to engage companies through shareholder proposal has likely made investors longer-term. Rather than sell, they can engage and invest their time and energy into the success of the company.

So it is therefore not a surprise that corporate leadership across the country is speaking up more regularly and forcefully about the need for companies to have positive environmental and social impacts. At a recent conference, Kenneth Frazier, CEO of Merck & Co stated that "I think as a group of business leaders, we have to think about the impact to our society of what's happening in the political discussions in our country." This perspective found alignment with BlackRock CEO Larry Fink who asserted that "I do believe that the demand for E.S.G. is going to transform all investing," when referring to how investors are beginning to meaningfully evaluate companies based, in part, on ESG metrics. Which also explains how corporate leadership is embracing the need to consider ESG issues. For example, at that same conference, Sundar Pichai, the chief executive of Google, said that even though he started his career as an engineer, increasingly, he spends significant amounts of time to thinking about how "technology impacts society at scale."[13]

Over the last year, industry associations such as the U.S. Chamber of Commerce, the National Association of Manufacturers, Business Roundtable, and the organizations they fund such as the misnamed Main Street Investor Coalition have constructed stories of shareholder proposals filed by malevolent or self-interested investors plaguing investors and haunting proxy ballots for years if not decades – so-called "zombie proposals".[14] Simply put, these **"zombies" do not exist**. ISS data shows that since 2011, there have been only about 20 environmental or social shareholder proposals that lingered on ballots with votes only in the teens and 20s for four or more years. This affected only 16 companies – 6 of which are either dual class or have high levels of insider ownership.[15]

It is notable that most of these approximately 20 proposals include shareholder proposals focused on climate change issues or political/lobbying spending disclosures. With respect to climate change shareholder proposals, we would note the strong analysis provided by committee member, Senator Brian Schatz in his November 9, 2018 letter to SEC Chairman Clayton which pointed out that investors are increasingly interested in how portfolio companies

---

[12] https://www.morningstar.com/content/usergenerated/asi/cloud/content/morningstar/en/blog/jcr:content/mainPar/journal/sustainability-index.social.0.10.html
[13] https://www.nytimes.com/2018/11/06/business/dealbook/business-reaches-a-turning-point.html
[14] For example, https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf
[15] https://www.ciiref.org/resubmission-thresholds

are managing climate risk.[16] Specifically, investors "filed fewer than 10 climate change-related shareholder proposals in 2000, over 25 in 2005, over 40 in 2007, over 60 in 2015, and already over 70 this year, as of July 12, 2018." He went on describe the relatively high votes achieved by these proposals including three majority votes in 2018.

The investor interest in climate change is found elsewhere as well. The Climate Action 100+, an organization supported by 310 investors with $32 trillion in assets under management, including PIMCO, Northern Trust Asset Management, Deutsche Asset Management, Manulife Asset Management, and HSBC Global Asset Management, is actively engaging the world's 100 largest GHG emitters. This group requests the companies publicly disclose their GHG emissions reduction targets and plans to utilize existing technology solutions to meet such targets.[17] And one of the recommendations of the Task Force on Climate-related Financial Disclosures, whose members include JPMorgan Chase, UBS Asset Management, Generation Investment Management, and BlackRock, is: "Describe the targets used by the organization to manage climate-related risks and opportunities and performance against these targets."[18]

With respect to political/lobbying spending disclosures proposals, an SEC rulemaking petition[19] on this issue submitted by a number of law school professors including now-Commissioner Robert J. Jackson, Jr. has received over a million investor comments in support of this rule.[20] These are not narrow interests of fringe investors. These are issues which achieve the support of significant pluralities of investors at a wide range of companies.

Looking at the various industry materials on resubmission thresholds, it would appear that these organizations are seeking resubmission thresholds of 6% for the first vote; 15% for the second vote, and 30% for the third vote. What this means is that their primary complaint is with proposals that are on the ballot year after year in the 10% to 29% range. And accordingly, votes in the 30s or 40s are perfectly acceptable. With this position in mind, it is reasonable to ask, how many environmental and social proposals are there in the teens and 20s. As cited above, ISS data shows that since 2011, there have been only about 20 environmental or social shareholder proposals that lingered on ballots with votes only in the teens and 20s for four or more years. This is an infinitesimal number, especially if considered within the context of the approximately 1000 environmental and social proposals filed in that time period.

---

[16] https://www.sec.gov/comments/4-725/4725-4635935-176320.pdf
[17] https://climateaction100.wordpress.com
[18] https://www.fsb-tcfd.org
[19] https://www.sec.gov/rules/petitions/2011/petn4-637.pdf
[20] https://thehill.com/blogs/pundits-blog/finance/274433-political-spending-disclosure-and-the-sec

So in reviewing the Nation Association of Manufacture's letter[21] of October 30, 2018 on shareholder proposals, one can only conclude that its allegation that "the proxy process has in recent years been hijacked by activists that seek to force companies to act according to their own narrow interests rather than the good of the business or long-term investor returns" is nothing less that overblown hyperbolic rhetoric devoid of substance. In fact, it is quite telling that the NAM never actually identifies specifically which shareholder proposals are "narrow", "focused on social and political issues", or "goals that are better addressed by Congress or other policymaking institutions." In fact, the rhetoric is strikingly similar to language used by American Outdoor Brands CEO James Debney earlier this year when he attacked a shareholder proposal arguing that the shareholder proposal process has become hijacked by a "political agenda." In the AOB case, the shareholder proposal, which was filed by nuns and focused on gun safety, received a 58% vote at the company 2018 annual meeting.[22]

Before embarking on the resource intensive process of either a rulemaking or legislation, policy makers should first conclude that there is sufficient justification for doing so – that there is a problem that in fact needs to be solved. A 14a-8 rulemaking or aligned legislation would undoubtedly attract enormous attention, demand significant resources, and perhaps inevitably lead to litigation - with little certainty about the result of that multi-year process. And for what, to remove a handful of useful and valuable shareholder proposals from future proxies?

There is no evidence that there is a problem with resubmission thresholds that warrants a change. In fact, the evidence is abundant that the current resubmission thresholds are well functioning and meet the needs of the investing community.

Thank you for taking our views into consideration. If you have any questions regarding the contents of this letter, please contact me directly at jkron@trilliuminvest.com.

Sincerely,

Jonas D. Kron
Senior Vice President

[21] https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf
[22] https://www.nbcnews.com/news/us-news/how-seattle-nun-led-shareholder-revolt-against-gun-makers-n915006

T.RowePrice®
INVEST WITH CONFIDENCE

December 13, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: Proxy Process and Rules: Examining Current Practices and Potential Changes

Dear Mr. Chairman and Ranking Member Brown:

On December 6, 2018, the US Senate Committee on Banking, Housing, and Urban Affairs held a hearing on "Proxy Process and Rules: Examining Current Practices and Potential Changes." We would like to thank the Committee for hosting the hearing and for the opportunity to provide our perspective on the issues raised during that discussion, particularly on the role of proxy advisory firms.

T. Rowe Price is in a unique position as both an institutional client of a major proxy advisory firm as well as a corporate issuer covered by proxy advisory firm research and recommendations. T. Rowe Price serves as investment adviser to a wide variety of clients, from individual savers to large institutions. As of November 30, 2018, T. Rowe Price and its affiliates managed $1.032 trillion in assets.

As an investment adviser subject to the Investment Advisers Act of 1940, T. Rowe Price is keenly aware of the essential role that the fiduciary standard plays in protecting our clients' interests with respect to all aspects of the advisory relationship, including voting proxies. We retain the proxy advisory firm Institutional Shareholder Services ("ISS") to provide fiduciary-level proxy advisory and voting services. These services include voting recommendations that are customized to conform with T. Rowe Price voting guidelines, as well as vote execution and regulatory reporting across the many markets globally where we invest. We rely on ISS to provide advisory and voting administration services that are accurate, timely, and objective.

T. Rowe Price Associates, Inc.
T: 410-345-2000
F: 410-345-6575

100 East Pratt Street
Baltimore, MD 21202

T.RowePrice®

What was most striking to us about the Committee hearing and recent SEC roundtable on the proxy process was the degree of consensus among investors, issuers, service providers, academics and other stakeholders that the systems involved in proxy voting in the United States are badly outdated. Indeed, during the SEC roundtable, participants made it abundantly clear that fixing the "proxy plumbing" is far more important than proxy advisor registration — imposing additional registration requirements on proxy advisory firms will not help to address the most critical areas of the proxy process in need of improvements, including the lack of end-to-end vote confirmation and verification. We strongly believe that shareholders deserve to know that their proxy votes are being counted, and counted accurately. In fact, we cannot think of a more important first step toward improving the proxy process for the SEC to take than ensuring that proxy votes are consistently and transparently tabulated.

As the SEC works toward addressing these issues, we urge the Committee to remain focused on facilitating the SEC's efforts to improve the infrastructure of the proxy system, rather than imposing legislative mandates that would divert SEC resources away from where they are needed most.

Proponents of additional regulatory requirements for proxy advisory firms assert that the activities of these firms result in undue influence over the voting decisions of institutional investors. This has not been our experience, and we believe an objective analysis of the voting record of institutional investors on non-routine matters would provide ample proof that investors in this market express thoughtful, varied, and independent views on the voting matters before them.

T. Rowe Price has established a Proxy Committee to develop our firm's positions on all major proxy voting issues, create guidelines, and oversee the voting process to ensure that proxies are voted solely in the interests of our clients. In establishing our proxy guidelines each year, the Proxy Committee relies upon our own fundamental research, independent research provided by ISS as our proxy advisor, and information presented by company management and shareholder groups. Thus, we make our own voting decisions using the independent research provided to us by our proxy advisor as one factor among many used to inform our firm's voting positions.

Proponents of additional regulatory requirements for proxy advisory firms have raised concerns regarding the accuracy of proxy advisor reports, and suggested that issuers should be permitted to review and comment on proxy reports before the reports are shared with the proxy advisors' clients. From T. Rowe Price's perspective as a corporate issuer, we appreciate having effective ways to address factual errors in proxy advisor research reports and find current practices, including the ability to file amended proxy statements with the SEC, to be sufficient. As described during the SEC roundtable and in separate letters to this Committee, both ISS and Glass Lewis, the largest proxy advisory firms operating in the US, have transparent mechanisms in place for issuers to address any factual errors in their data analyses.

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

T. Rowe Price®

prevent issuers from influencing the research produced by investment firms. For example, FINRA Rule 2241 requires broker-dealers to adopt and maintain written policies and procedures "reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and to prevent the use of research reports or research analysts to manipulate or condition the market or favor the interests of the member or a current or prospective customer or class of customers." We fail to see why the independence of sell side recommendations should be afforded greater protection than the independence of proxy recommendations.

As noted above, we rely on ISS to provide advisory and voting administration services that are accurate, timely, and objective. We therefore would have significant concerns with any proposed legislative or 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.

For these reasons, we strongly believe that the SEC's highest priority with respect to proxy voting and proxy advisory firms should be to modernize our proxy infrastructure. We would welcome the Committee's help in this regard to focus the SEC's limited staff and resources on addressing those issues that could truly make a meaningful difference to the proxy process, rather than those that are the most politically heated.

Thank you again for this opportunity to comment on issues with US proxy voting, and for the Committee's consideration of our perspective. Please do not hesitate to contact us if we could be of further assistance.

Respectfully,

Donna F. Anderson
Head of Corporate Governance

Eric Veiel
Co-Head of Global Equity

cc: Members of the Senate Banking Committee

US SIF

The Forum for Sustainable and Responsible Investment

December 4, 2018

The Honorable Michael Crapo
Chair
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
US Senate
Washington, D.C. 20510

RE: Hearing on Proxy Process and Rules, December 6, 2018

Dear Chair Crapo and Ranking Member Brown,

On behalf of US SIF: The Forum for Sustainable and Responsible Investment, I respectfully submit the following comments to the record for the U.S. Senate Banking Committee's hearing titled "Proxy Process and Rules: Examining Current Practices and Potential Changes," on December 6, 2018. US SIF's comments focus on maintaining the current shareholder proposal process, including supporting the role proxy advisors play for investors.

US SIF is the leading voice advancing sustainable, responsible and impact (SRI) investing across all asset classes. Our mission is to rapidly shift investment practices toward sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Our member firms and organizations represent more than $3 trillion in assets under management.

The US SIF Foundation's *Report on US Sustainable, Responsible and Impact Investing Trends 2018* finds that $12 trillion in US-domiciled assets under management use SRI criteria, representing 1 in 4 dollars under professional management.[1] Money managers who responded to the report's survey cited client demand, risk, return, social benefit, mission and fiduciary duty as the leading reasons that they consider environmental, social and governance factors.[2]

The Shareholder Proposal Process Works Well

The shareholder proposal rule is a vitally important, market-based mechanism for a range of investors to communicate with boards, management and other shareholders on important corporate governance, risk and policy issues affecting companies. This process is one of the most visible and verifiable ways in which investors can practice responsible ownership. A key element is to allow shareholders to raise issues before a crisis that erodes shareholder value arises.

[1] *Report on US Sustainable, Responsible and Impact Investing Trends 2018* US SIF Foundation, Washington, DC. www.ussif.org/trends
[2] Ibid, p. 28, fig. 2.13

Those who are advocating for weakening shareholder rights argue that submission criteria and resubmission thresholds must be revised upwards. It is US SIF's view that those advocates have not substantiated a clear problem that would require Congress or the Securities and Exchange Commission (SEC) to alter Rule 14a-8. The current vote thresholds allow relevant issues to be resubmitted and to build support gradually.

Shareholder proposals that required resubmission to build support have contributed to significant and tangible benefits at countless companies. Shareholder proposals are responsible for:

- the now standard practice that independent directors constitute at least a majority of the board and now mandated by US stock exchanges' listing standards;
- "say-on-pay" vote requirements – now mandated by the Dodd-Frank Act;
- wide-scale adoption of international human rights principles as part of corporate codes of conduct and supply chain policies, protecting companies from legal and reputational risk;
- an increase to 81 percent at S&P 500 companies that publish sustainability reports in 2015 compared to just under 20 percent in 2011.[3]

Changes to resubmission thresholds will have unintended consequences that are costly and inefficient. Alternatives to shareholder proposals include voting against directors, lawsuits, books and records requests and requests for additional regulations. Each of these is more onerous and adversarial than including a 500-word proposal in the proxy statement for the consideration of shareholders.

Most importantly, any analysis of the costs of the shareholder proposal process must be balanced against the benefits. Poor corporate governance and inadequate environmental, social and governance (ESG) practices hurt company performance and investor returns.

Further information about the impacts of this change and the reasons for maintaining the current shareholder rule and resubmission levels can be found in this document, which US SIF has co-authored.

Defending Shareholder Engagement

In a comment letter to the SEC Staff Roundtable on the Proxy Process, the National Association of Manufacturers (NAM) repeatedly and disingenuously refer to the shareholder process as being "hijacked" by political activists and make unsubstantiated claims that this abuse is creating an increase of "zombie" proposals that reappear year after year.[4] The letter states, "...the proxy process has in recent years been hijacked by

[3] https://www.ga-institute.com/press-releases/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html
[4] https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf

activists that seek to force companies to act according to their narrow interests rather than the good of the business or long-term investor returns."

This is not the case for two reasons. First, Rule 14a-8 offers issuers a number of pathways to seek no-action relief to exclude proposals. Second, just because NAM attempts re-frame certain issues in the media as "political" does not make those issues immaterial to the well-being of the corporation. Also, NAM fails to identify which of these issues are "political" or become "zombies". Simply stated, NAM has not presented credible arguments.

Proxy Advisory Firms

The US system of corporate governance relies on the accountability of boards of directors to their shareholders, and the proxy system is an important means by which shareowners communicate with companies and with one another on substantive issues. Each year, companies seek votes from shareholders on items pending on their annual proxy statements, including approval of their boards of directors. According to the SEC, more than 600 billion shares are voted at more than 13,000 shareholder meetings every year[5]. The SEC requires investment managers to disclose to clients their proxy voting policies and their voting records.

The investment firms and asset owners that are US SIF members are active leaders in proxy voting and take this responsibility very seriously. They use proxy voting advisory firms for assistance in digesting and analyzing the often dense and complicated questions that appear in company proxy statements before casting their shares. These proxy advisory firms issue vote recommendations on the proposals submitted by management and by shareholders. The proxy advisory firms will also execute votes on behalf of asset owners or their investment managers in line with the client's guidelines if contracted to do so.

US SIF members frequently use proxy advisory services to help with this responsibility and thus are very concerned about the calls for new, onerous regulations on proxy advisory firms. We emphasize the following key points:

- There is already a robust existing regulatory structure for proxy advisory firms. Current SEC 2014 guidance on proxy advisors makes it clear that investment advisors have a duty to maintain sufficient oversight of third-party voting agents. Therefore, there is no need for further regulatory action.

- Proxy advisory firms neither control nor dictate how clients should or do vote. Instead, investors take the proxy voting recommendations into account as they vote according to their proxy voting guidelines and judgment, which may differ

[5] U.S. Securities and Exchange Commission, "SEC Votes to Seek Public Comment on U.S. Proxy System," July 14, 2010. Available at http://www.sec.gov/news/press/2010/2010-122.htm.

from recommendations by proxy advisory firms.

- The primary role of proxy advisory firms is to serve investors (not "companies"), who are the major recipients of proxy advisory research, analysis or recommendations.

- 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.

- Proxy voting advisory firms help investors meet their fiduciary responsibilities by providing efficient and cost-effective research services to them to inform their proxy voting decisions.

We believe that attempts to constrain the important work of proxy advisory firms also weaken the ability of investors to fulfill their fiduciary duties. Therefore, we urge you not to consider any further attempts to restrict the work of proxy advisory firms.

Thank you for considering our views. If you have any questions regarding the contents of this letter, please contact me directly at lwoll@ussif.org or Bryan McGannon, US SIF's Director of Policy and Programs at bmcgannon@ussif.org.

Sincerely,

Lisa Woll
CEO

Boston Trust & Investment Management Company

Walden Asset Management
Advancing sustainable business practices since 1975

November 30, 2018

The Honorable Michael Crapo
Chair
Committee on Banking, Housing & Urban Affairs
U. S. Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing & Urban Affairs
U. S. Senate
Washington, DC 20510

Re: Hearing on Proxy Process and Rules, December 6, 2018

Dear Chair Crapo and Ranking Member Brown,

Boston Trust & Investment Management Company and our sustainable investment practice, Walden Asset Management ("Boston Trust/Walden"), is an investment management firm working with institutional and private wealth clients who represent nearly $9 billion in assets.

The hallmark of Boston Trust / Walden's investment approach is our emphasis on identifying higher quality investments with sustainable business models. Boston Trust believes that environmental, social, and governance (ESG) factors are an appropriate and material part of a comprehensive analysis of long-term investment prospects. We therefore believe it is important to consider a company's management of significant ESG risks and opportunities as part of our fiduciary duty to all clients. ESG integration builds on our belief that companies protect and enhance their long-term profitability if they integrate responsible behavior into the fabric of their business practices. As part of our effort to identify and invest in high quality companies, ESG factor integration brings an awareness of important long-term financial considerations and risks that may otherwise be overlooked.

We appreciate that the Senate Banking Committee is holding a hearing to address issues related to the proxy process. This is an important and timely topic.

As you know, the Securities and Exchange Commission held a Roundtable on November 15th and welcomed letters of comment from concerned parties. Numerous investors and a number of trade associations sent letters of comment and a selected number participated in the Roundtable discussion.

You will note that the investor speakers and letter writers do not believe the Securities and Exchange Commission Rules governing shareholder resolutions need significant reform. Most of the comments explained the positive impact shareholder resolutions play in encouraging more transparency and improvements in policies and practices on governance, environmental and social issues.

Thus, investors were distressed when trade associations like the Business Roundtable, U.S. Chamber of Commerce and National Association of Manufacturers, were aggressively attacking the shareholder resolution process and villainizing the proponents.
As a result, our firm wrote a response explaining the rationale for engagement on ESG issues using major investment firms as examples.

We believe this is an important perspective for the Senate to receive as well, so we are pleased to submit this letter for your consideration.

Along with most of the 2,000 global investor signatories to the Principles for Responsible Investment (PRI), who collectively represent more than $80 trillion in assets under management, we also recognize the importance of company engagement to promote more sustainable business policies and practices. For Boston Trust/Walden, this includes the filing of shareholder resolutions, when appropriate. We filed our first shareholder proposal over 30 years ago in 1986. This year marked the filing of our 500th shareholder proposal, of which 40 percent were withdrawn after having reached constructive agreements with management. We also have developed a detailed set of Proxy Voting Guidelines to assist in our consideration of ESG factors in proxy voting.

Challenges to shareholder resolutions put forth by industry groups have a long history and have been increasing markedly in recent years. Numerous investors are providing comment letters to the SEC, providing background on the philosophy behind shareholder proposals and the significant positive impact they have had on company policies and practices on important and material ESG issues. Of course, we can also point to examples of resolutions that were poorly crafted or misguided in their request to company boards. In such cases, investors could and should have voted against such shareholder proposals.

Boston Trust/Walden's comments that follow focus on recent acrimonious and misguided attacks on this shareholder right, particularly by industry associations, which aim to limit significantly shareholder proponents and the resolution process.

The U.S. Chamber of Commerce, a longtime critic of shareholder resolutions, was joined three years ago by vocal opposition from the Business Roundtable. Most recently, the National Association of Manufacturers (NAM) and the newly formed Main Street Investors Coalition, which is housed at NAM, have added their voices against the current proxy process. These industry groups regularly challenge the credibility and motives of shareholder resolution proponents who engage with companies and vote their proxies conscientiously on ESG matters.

As an example, we copy below and attach comments excerpted from the October 30, 2018 NAM letter to the SEC (Appendix A). NAM asserts that:

- a flawed proxy process can be hijacked by unregulated third parties with little-to-no-stake in company's success or investor returns
- These outside actions often pursue agendas divorced from shareholder value creation
- the proxy process has...been hijacked by activists that seek to force companies to act according to their narrow interests
- in many instances, these third parties take the form of activists pursuing political goals unrelated to business growth

- The proxy ballot...has devolved into a shouting match focused on social and political issues

These characterizations by NAM are similar to those of the U.S. Chamber of Commerce and Business Roundtable. They represent a simplistic and inaccurate portrayal of the motives and actions of investors and shareholder proponents who believe in and pursue active ownership strategies. As company executives and boards who engage with their shareowners well know, the motivation of most actively engaged investors is appropriately focused on protecting shareholder value.

Investors consistently and effectively raise concerns about risk mitigation and long-term value creation as they discuss topics such as governance reforms, climate change, board diversity, and business ethics. Our experience suggests that if NAM or the Business Roundtable had discussed the drivers of investor concern with their member companies, they would have received thoughtful feedback of the positive impact from countless conversations between companies and investors. A review of the policies of investor members of CII, PRI, USSIF, Ceres, and ICCR would also demonstrate the reality that enhancing and protecting shareholder value is central to these investors. Likewise, this motivation is evident in the statements and policies of major public pension funds such as CalPERS, CalSTRS, Connecticut, Illinois, New York City, New York State, Rhode Island, and Washington state.

Major investment firms such as BlackRock, State Street Global Advisors, and Vanguard have articulated the foundation and rationale for their engagements with companies (numerous excerpts are documented in Appendix B). The common themes are that engagement and proxy voting on ESG considerations are motivated by investment managers' fiduciary duty, assessment of risk and long-term shareholder value, and commitment to client objectives. There is no evidence of "a political agenda outside of shareholder value creation" among these major investment institutions, as described in the NAM comment letter to the SEC.

In summary, we believe it is timely and relevant to respond to erroneous campaigns by the Business Roundtable, NAM, and U.S. Chamber of Commerce that we believe mischaracterizes the motives and beliefs of institutional investors who utilize the proxy process, engage companies as shareholders, and vote their proxies.

Sincerely,

Tim Smith
Director of ESG Shareowner Engagement

Appendix A: Excerpts from National Association of Manufacturers (NAM) October 30, 2018 comment letter to the SEC for the November 15 Roundtable on the Proxy Process

Source: https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf
Author: Chris Netram *Vice President, Tax and Domestic Economic Policy*

###

Manufacturers know that the proxy ballot is central to enabling smart business growth and strong investor returns. A well-calibrated proxy process allows company management to engage in a productive dialogue with investors, who are of course the ultimate owners of any publicly-traded corporation, about key aspects of the business. Conversely, a flawed proxy process can be hijacked by unregulated third parties with little-to-no stake in company success or investor returns. These outside actors often pursue agendas divorced from shareholder value creation and divert valuable resources from job creation and R&D.

II. Shareholder Proposals

NAM members value a constructive dialogue with shareholders...[T]he proxy process has in recent years been hijacked by activists that seek to force companies to act according to their own narrow interests rather than the good of the business or long-term investor returns. In many instances, these third parties take the form of activists pursuing political goals unrelated to business growth and the corresponding capital investments, R&D spending, and value creation that come with it. The proxy ballot was designed for the majority of investors to constructively engage with company management, but it has devolved in many ways into a shouting match focused on social and political issues.

However, the NAM does not believe that it is appropriate for activists to abuse the proxy ballot to push goals that are better addressed by Congress or other policymaking institutions. Indeed, a recent academic study co-authored by Professor Joseph Kalt of Harvard University found that ESG proposals detract from shareholder value, contradicting activists' claims that such proposals are beneficial to shareholders. This issue is exacerbated when investment advisers engage in political activity by leveraging the shares they manage – the retirement savings of millions of Americans who are unaware that their fund managers have a political agenda outside of shareholder value creation.

Resubmission Thresholds

Politically-motivated activism divorced from long-term shareholder value creation has only increased since 1997, further underscoring the need for reform...The continued resubmission of "zombie" proposals distracts from legitimate issues on the proxy ballot and ignores the wishes of the 90 percent or more of investors who rejected them in the first place.

Similarly, the SEC should make targeted reforms to the initial submission threshold under Rule 14a-8(b). This threshold allows any investor that has held just $2,000 worth of company stock for at least one year to place a proposal on the proxy ballot. This incredibly low threshold has given rise to individuals who spam company proxy ballots by taking *de minimis* positions in a wide range of issuers so as to qualify their pet proposals on dozens of company proxy ballots.

Proxy Voting Guidance

To ensure that investment advisers that vote on behalf of Main Street investor clients remain solely focused on their fiduciary duty to enhance long-term shareholder value, SEC staff should issue guidance under the Proxy Voting Rule that clarifies a fund manager's obligations when considering how to vote on a politically-driven proposal.

Specifically, the NAM believes that investment advisers should have policies and procedures in place that require the identification of a clear link to shareholder value creation before voting in favor of any proxy proposal, including those focused on ESG topics – or have procedures that allow more direct input from retail shareholders themselves on these issues.

Appendix B: Excerpts from Leading Investment Managers on their Rationale for Company Engagement and Proxy Voting Practices

1. State Street Global Advisors (SSGA)

   Source: https://www.ssga.com/investment-topics/environmental-social-governance/2017/perspectives-on-effective-climate-change-disclosure.pdf

   - State Street Global Advisors (SSGA) believes that boards should regard climate change as they would any other significant risk to the business and ensure that a company's assets and its long-term business strategy are resilient to the impacts of climate change

   - Over the course of four years, SSGA has held over 240 climate-related engagements with 168 companies. Through these engagements we found that few companies can effectively demonstrate to investors how they integrate climate risk into long-term strategy. This is particularly important for companies in the oil and gas, utilities and mining sectors where long investment horizons could render assets stranded

2. Vanguard

   Source: https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf

   - This report outlines the activities of Vanguard's Investment Stewardship team for the 12 months ended June 30, 2018.

     Our team had a productive year on behalf of Vanguard's more than 20 million clients worldwide. We voted your funds' proxies at nearly 20,000 meetings and engaged directly with more than 700 portfolio companies. We also shared our perspectives through our advocacy efforts with corporate director audiences, other investors, regulators and policymakers, and other stakeholders.
     Glenn Booraem, Investment Stewardship Officer

   - Engagement: We meet with portfolio company executives and directors to share our long-term orientation and principled approach and to learn about companies' corporate governance practices. We characterize our approach as deliberate, constructive, and results-oriented.

   - Discussed board composition in more than **50%** of our engagements, consistent with the 2017 proxy year.

   - Engaged with over **200** companies in carbon-intensive industries. Supported **11** out of **76** environmental disclosure proposals, compared with **2** out of **92** in 2017.

   - Engagement is the foundation of our Investment Stewardship program. Because our index funds are practically permanent owners of portfolio companies, we aim in our engagements to build a strong understanding of how companies govern their long-term strategy.

Engagement has improved substantially over the last decade. It started as discussions with company leaders regarding matters on the ballot at an upcoming shareholder meeting. Over time, it has evolved into a broader and deeper discussion with both directors and management on principle-based matters that go well beyond the year's ballot. This has made engagement a year-round process – not just a proxy season phenomenon – and has expanded its reach globally.
W. Robert Main III, CFA, Head of Portfolio Company Engagement, Analysis and Voting

- Our philosophy on sustainability is grounded in long-term value creation. We aren't alone in this thinking. A consensus is growing in the investment community that certain environmental, social and governance (ESG) matters can significantly affect a public company's long-term financial value.

  Given this potential impact, Vanguard believes it is essential that company boards and senior management teams appropriately oversee these sustainability risks – and opportunities – as they would other material issues. It is equally important that companies be transparent about sustainability matters and disclose them to investors. As a practically permanent owner on our fund investors' behalf, Vanguard needs the market to efficiently value stocks based on all material risks.
  Insights from Senior Strategist Marc Lindsay, J.D.

Source: https://about.vanguard.com/investment-stewardship/governance-letter-to-companies.pdf, F. William McNabb III, Chairman and CEO

- Our investors depend on Vanguard to be a responsible steward of their assets, and we promote principles of corporate governance that we believe will enhance the long-term value of their investments.

- **Directors are shareholders' eyes and ears on risk.**

  Climate risk is an example of a slowly developing and highly uncertain risk—the kind that tests the strength of a board's oversight and risk governance. Our evolving position on climate risk (much like our stance on gender diversity) is based on the economic bottom line for Vanguard investors. As significant long-term owners of many companies in industries vulnerable to climate risk, Vanguard investors have substantial value at stake.

  Although there is no one-size-fits-all approach, market solutions to climate risk and other evolving disclosure practices can be valuable when they reflect the shared priorities of issuers and investors. Our participation in the Investor Advisory Group to the Sustainability Accounting Standards Board (SASB) reflects our belief that materiality-driven, sector-specific disclosures will better illuminate risks in a way that aids market efficiency and price discovery. We believe it is incumbent on all market participants—investors, boards, and management alike—to embrace the disclosure of sustainability risks that bear on a company's long-term value creation prospects.

- **Engagement builds mutual understanding and a basis for progress.**

  Timely and substantive dialogue with companies is core to our investment stewardship approach. We see engagement as mutually beneficial: We convey Vanguard's views and we hear companies' perspectives, which adds context to our analysis.

- Our four pillars and our increased focus on climate risk and gender diversity are not fleeting priorities for Vanguard. As essentially permanent owners of the companies you lead, we have a special obligation to be engaged stewards actively focused on the long term.

Source: https://www.reuters.com/article/us-vanguard-climate/vanguard-seeks-corporate-disclosure-on-risks-from-climate-change-idUSKCN1AU1KJ interview with Glenn Booraem, Investment Stewardship Officer

- "Our support for these proposals is not a matter of ideology, it's a matter of economics. To the extent there are significant risks to a company's long-term value proposition, we want to make sure there is long-term disclosure of those risk to the market."

3. ClearBridge Investments

Source: https://www.clearbridge.com/content/dam/clearbridge/banner-images/ESGcampaign2017/cbi-esg-engagement-report.pdf

- **Firm Overview**

  - $124.3 billion—Assets for which ESG risk and opportunities are analyzed
  - 1,000+—Company meetings per year
  - 334—Companies where we are a top 20 shareholder

- **Company Engagement**

  Public equity ownership can also be a powerful tool to influence companies and drive change. As active investors in the public markets, we engage with company management on a variety of material ESG issues and urge them to improve policies and practices.

  As a firm, ClearBridge conducts over 1,000 company meetings ever year.

  As a large institutional money manager, just asking the right questions, whether about gender equality, energy efficiency, better board governance or disclosure, can result in positive changes in the mindset and eventually the operations of public companies.

- **Proxy Voting**

  The proxy voting process is one of the more visible and often powerful tools public equity investors may use to advocate for sustainable business impact.

  Our votes on shareholder proposals are an effective way to signal confidence in the companies we own or to suggest the need for a change in policies, disclosures or related aspects of a company's business.

  In voting proxies, we are guided by general fiduciary principles. Our goal is to act prudently and solely in the best interest of the beneficial owners of the accounts we manage. We attempt to provide for the consideration of all factors that could affect the value of the investment and will vote proxies in the manner that we believe will be consistent with efforts to maximize shareholder values.

- **Measuring Progress on Climate: Carbon Intensity Analysis**

  Furthermore, we are committed to engaging companies on climate change issues. We advocate in meetings with management teams to advance issues such as carbon emissions disclosure, setting benchmarks on emissions reductions, influencing corporate strategy to be longer-term and improving supply chain efficiency.

4. Neuberger Berman

Source: Neuberger Berman 2017 Engagement and Proxy Voting Report (www.nb.com)

- **Our Investment Platform**
  - AUM $295bn

- **Chief Investment Officer Statement** (Mr. *Joseph V. Amato*)

  An important part of how we serve our clients is by engaging with corporate management teams and board members. Active managers that hold concentrated positions with long investment horizons have an outsized responsibility to use their formal and informal influence to support sustainable value creation. We have a long tradition of being unafraid to take strong positions in order to bring positive change, whether at individual companies or in the market as a whole. This work is a core responsibility of each of our portfolio managers and analysts—we are all stewards of our clients' capital.

  With more than 1,500 in-person management meetings held in our offices for equity investments during 2017, we are in constant dialogue with the companies in which we invest.

- **Approach to Engagement at Neuberger Berman**

  In 2017, we conducted more than 1,500 in-person and in-depth meetings with management teams in our offices for equity investments and another 750-plus for fixed income investments. We aim to prioritize engagements that have the largest impact on the protection and improvement of our clients' assets, be it through the advancement of actionable disclosure, understanding of risks and risk management at an issuer, or through influence and action to mitigate risks and take advantage of investment opportunities. In 2017 we conducted structured engagements with over 590 companies across our equity portfolio holdings alone.

- **Voting Statistics**

  In 2017, we supported over 200 shareholder proposals (approximately 38%) and this reflects our stronger, more detailed stances on a number of ESG issues as articulated in our public Guidelines.

  We do not take the view that opposing management on any issue is a confrontation; as mentioned, proxy voting is but one method of engagement and we pursue a variety of methods to assure that our clients' assets are managed by company insiders with the same care and attention as their portfolios are by our managers.

5. BlackRock

Source: https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf

- "Your company's strategy must articulate a path to achieve financial performance. To sustain that performance, however, you must also understand the societal impact of your business as well as the ways that broad, structural trends – from slow wage growth to rising automation to climate change – affect your potential for growth."
  Larry Fink, BlackRock, Annual Letter to CEOs, January 2018

- How do asset managers approach investment stewardship and to what degree do they factor in environmental, social, and governance (ESG) considerations?

  For BlackRock, the answers are inseparable from our role as a fiduciary to our clients' assets. **Our mission is to create a better financial future for our clients and our number one focus is on generating long-term sustainable performance.** Just as we expect the companies in which we invest to understand the macroeconomic and industry trends in which they operate, we also believe that a company's awareness of regulatory and societal trends helps drive long-term performance and mitigate risk.

- **Investment Stewardship** encompasses engagement with companies and the voting of proxies.

  BlackRock takes an **engagement-first approach** to investment stewardship, emphasizing direct dialogues with companies on issues that we believe have a material impact on financial performance.

- Proxy voting is often associated with investment stewardship, however, voting is not the only form that stewardship can take. Engagement can also be an important component of asset owners' and asset managers' stewardship activities. Engagement can include one-on-one meetings with representatives of company boards and/or management, writing letters to companies, and a variety of other activities.

- BlackRock's approach to investment stewardship is driven by our role as a fiduciary to our clients, the asset owners. In this role, we look to engage constructively with company management to maximize the value of our clients' investments in each individual company. BlackRock has had an in-house team dedicated to investment stewardship since its inception.

- **Engagement**

  Our Investment Stewardship team engages extensively with companies around the world on issues that we have identified as material to companies' long-term financial sustainability, and votes on behalf of our clients and funds that have delegated voting authority to BlackRock.

  As a long-term investor, we are willing to be patient with companies when our engagement affirms they are working to address our concerns. However, our patience is not infinite – when we do not see progress despite ongoing engagement, or companies are insufficiently responsive to our efforts to protect the long-term economic interests of our clients, we will exercise our right to vote against management recommendations.

- **Shareholder Proposals**

  Shareholder proposals are one mechanism for shareholders to put an issue on the ballot at a company's shareholder meeting.

  A subset of asset owners, and some asset managers use shareholder proposals as a tool to signal investor concern to companies about emerging issues and/or as a catalyst for engagement.

  Companies can also discuss shareholder proposals with its proponents, and if an agreed upon outcome can be reached in advance of the vote, the shareholder could withdraw the proposal. Withdrawals of shareholder proposals occur with some frequency. For example, of the 608 shareholder proposals filed in the 2017 Form N-PX filing year, 123 (20.2%) were withdrawn.

6. JPMorgan Chase

   Source: https://www.jpmorgan.com/global/research/esg

   Critics of ESG investing have long seen it as an approach where investors have to sacrifice potential returns in order to match their investments with their values or mandates, but ESGQ shows how investing sustainably can actually boost returns.

"The best way for investors to capture these changes and identify new issues and controversies is to better understand the building blocks of E, S, and G. When ESGQ is added to traditional investment styles such as value, growth, momentum and quality, the composite returns are higher, sharp ratios or risk adjusted returns increase dramatically, but drawdowns are significantly lower," he added.
Khuram Chaudhry, European Equity Quant Strategist & Lead ESGQ Analyst

NATIONAL ASSOCIATION OF
Manufacturers

Chris Netram

Vice President,
Tax and Domestic Economic Policy

December 6, 2018

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the National Association of Manufacturers (NAM) and the 12 million men and women who make things in America, I write to thank you for holding today's hearing on the proxy process. As with the SEC's recent proxy roundtable, this hearing provides a valuable opportunity for Congress to consider important proxy issues that impact Main Street investors' financial security.

In particular, the NAM remains concerned about the influence of proxy advisory firms, and we encourage the Banking Committee to consider ways that Congress can provide certainty to the market and implement effective guardrails that prioritize accuracy, transparency, and investment advisers' fiduciary duty to the Main Street investors whose shares are often voted in accordance with proxy firm recommendations.

To be clear, the NAM does not object to proxy firms playing a role in providing information to the marketplace. To the extent that their relationships with institutional investors result in more information for the market and enable these institutions to better serve their Main Street investor clients, the NAM believes that proxy firms can be constructive and provide a useful service. However, the current lack of effective guardrails has led proxy firms to be the *de facto* standard setters for public company governance. Fund managers at institutions, charged with voting an ever-increasing number of proxies on their clients' behalf, have turned to proxy firms to shape, and sometimes even cast, their votes – despite a lack of transparency, significant conflicts of interests, and demonstrable errors.

Ultimately, these unregulated firms have enormous influence over U.S. public companies and the life savings of millions of Main Street investors. The NAM strongly believes that targeted reforms are needed to reduce proxy firms' influence and allow investors to make informed proxy voting decisions.

Impact of Proxy Advisory Firms

The flaws embedded into the business model of proxy advisory firms are at this point well-documented, and manufacturers have time and again faced significant costs due to their influence:

- Proxy firms insist upon a one-size-fits-all approach to corporate governance, irrespective of the differences in companies' business models and the flexibility allowed under securities law;
- The process by which proxy firm recommendations are developed features a notable lack of transparency, and the firms' one-size-fits-all policies are likewise developed out of the public eye (unlike the SEC rules with which public companies must comply, which are of course subject to a rigorous notice-and-comment process);
- Proxy firm reports and recommendations have been shown to feature errors and misleading statements, ranging from specific incorrect facts to disingenuous assumptions about, for instance, a company's peer group or compensation practices;
- Proxy firms have been steadfastly resistant to engaging in a productive dialogue with issuers (indeed, one of the firms will only engage with companies in the S&P 500, while the other charges issuers a fee to review their draft recommendations);
- Proxy firms often engage in "robo-voting" on behalf of their clients, completely cutting investment advisers and their clients out of the process and depriving issuers of a chance to correct the record or help investors better understand their side of the story; and
- Proxy firms have *prima facie* conflicts of interest given that, of the two leading firms in the space, one is owned by an investor that sponsors proxy proposals and the other operates a consulting business that counsels companies on the very corporate governance policies on which the advisory side of the firm makes recommendations.

These factors result in flawed, conflicted recommendations being disseminated to the investors who rely on them to shape their proxy votes; meanwhile, correcting proxy firm errors distracts companies from business growth and shareholder value creation. It is clear that the time is right for Congress and the SEC to take steps to bring oversight to the proxy firm industry.

Policy Approaches to Proxy Firm Regulation

There is bipartisan interest in Congress in addressing the market distortion created by unregulated proxy advisory firms. Last year, the House of Representatives passed the Corporate Governance Reform and Transparency Act (H.R. 4015), sponsored by Reps. Sean Duffy (R-WI) and Gregory Meeks (D-NY), which would require the firms to register with the SEC under the Securities Exchange Act and meet certain standards related to errors, issuer engagement, and conflicts of interest in order to maintain their registration.

More recently, Sens. Jack Reed (D-RI), David Perdue (R-GA), Heidi Heitkamp (D-ND), Thom Tillis (R-NC), Doug Jones (D-AL), and John Kennedy (R-LA) introduced the Corporate Governance Fairness Act (S. 3614). The NAM is encouraged by this bipartisan first step toward Senate action on proxy advisory firms. This new bill would require the firms to register with the SEC under the Investment Advisers Act and set up an examination process under which the SEC would conduct regular inspections to check for policies to address conflicts of interest and material errors or misstatements. The bill would also require regular SEC reports to the Senate Banking and House Financial Services Committees outlining the SEC's perspectives on other reforms that might be needed to effectively regulate proxy advisory firms. This bill shows the strong bipartisan interest in addressing this important issue, and the NAM looks forward to working with the Banking Committee on proxy firm reforms.

In a recent comment letter[1] to the SEC, the NAM laid out additional approaches to proxy firm reform that Congress and the SEC should consider. First, we urged the SEC to replace the 2004 no-action letters issued to ISS and Egan-Jones (recently withdrawn by the SEC) with staff guidance or Commission rulemaking that better regulates the relationship between fund managers and proxy firms given investment advisers' fiduciary duty to the Main Street investors they represent. Institutional investors are both the firms' primary clients and everyday Americans' primary investment outlet; this nexus provides a critical opportunity to ensure that investment advisers are not over-relying on proxy firms at the expense of the long-term health of Main Street investors' retirement savings. We also suggested amendments to the exemptions from the proxy solicitation rules on which the firms rely that would address the flaws endemic to the proxy firm business model; these reforms would condition the exemptions on the firms instituting policies to disclose and mitigate conflicts of interest and establishing a robust issuer engagement process in the event of a contested recommendation.

The NAM urges the Banking Committee to consider each of these approaches, and others, in an effort to arrive at a legislative solution that ensures that investors are receiving accurate, conflict-free information from proxy advisory firms and allows manufacturers to focus on long-term growth, investment, and job creation.

Sincerely,

Chris Netram
Vice President, Tax & Domestic Economic Policy

---

[1] The NAM's comment letter is available at https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf.