Statement of the U.S. Chamber of Commerce

ON: Proxy Process and Rules: Examining Current Practices and Potential Changes

TO: United States Senate Committee on Banking, Housing, and Urban Affairs

BY: Thomas Quaadman, Executive Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

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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% 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 towards 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 fifteen 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% 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

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[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

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 US 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 1980's and 1990's, 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.

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[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

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% of the proxy advisory firm market, yet both are riddled with conflicts of interest, operate with little transparency, and are prone to making 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% 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 towards 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.

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[6] ISS 24.7% Glass Lewis 12.9% 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

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 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.

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[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.

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[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

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 five 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
- 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 – 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% 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% of their shares would automatically vote in line with an ISS recommendation, while others estimated that between 25-30% fell into that category. The amount of time granted to provide input ranged from 30 minutes to two weeks, with 1-2 days being the most common response. And only 39% 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 an error rate of approximately 2 to 2.5%. 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% mean 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% 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 of 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.

[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

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 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% 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 and their family members sponsored 25% 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% support on the previous submission if voted on once within the previous five years;

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

[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.

- Less than 6% support on the previous submission if voted on twice within the previous five years;
- Less than 10% support on the previous submission if voted on three or more times within the previous five years.

Thus, a proponent can keep resubmitting a proposal even if nearly 90% 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%-6%-10% system to a more reasonable 6%-15%-30%. 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 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% of these types of proposals passed;
- Zombie proposals made up 32% of all failed proposals; and
- Out of the 2,449 total proposals examined, 723 were zombie proposals—almost a full 30%.

Importantly, had the SEC implemented a new threshold rule of 6%-15%-30% prior to the period examined, only 27% of zombies would have been eligible for a fourth year on company ballots. In other words, more reasonable thresholds would in

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

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 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

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

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 interest 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% of retail shareholders voting their shares in 2018 (compared to 91% 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

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

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.