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*Vice President,
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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.

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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 letter¹ 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,

A handwritten signature in black ink, appearing to read "Chris Netram". The signature is fluid and cursive, with a long horizontal stroke at the end.

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>.