

Chris Netram

Vice President,  
Tax and Domestic Economic Policy

March 5, 2019

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Re: File No. 4-725: SEC Staff Roundtable on the Proxy Process

Dear Mr. Fields,

The National Association of Manufacturers (NAM) appreciates the opportunity to provide comments to the Securities and Exchange Commission (SEC) as a follow-up to its November 15, 2018, roundtable on the proxy process. We urge the Commission to build on the robust discussion of proxy advisory firms at the roundtable and take steps toward concrete reforms that would provide for effective SEC oversight of proxy firms and enhance the quality of information available to investors.

Manufacturers often turn to the capital markets to finance pro-growth activities like business expansion and job creation, which in turn set the stage for economic expansion right here in America. At the same time, manufacturing workers – 67 percent of whom participate in a workplace retirement plan<sup>1</sup> – depend on the public market to invest for the future. NAM members and their employees are significantly impacted by the outsized role that proxy advisory firms play in America's capital markets.

The NAM submitted a comment letter on October 30, 2018, in advance of the November roundtable<sup>2</sup>; as we said in that letter, proxy advisory firms "have enormous influence over the corporate governance policies of U.S. public companies – decisions that impact the direction of a business and the life savings of millions of Main Street investors." The NAM has no objection to proxy firms providing information to the marketplace; however, advice that is tainted by undisclosed conflicts of interest, errors, one-size-fits-all decision-making, and a lack of transparency imposes significant costs on manufacturers and manufacturing workers. We appreciate the SEC's continued attention to this vital issue, and we encourage the Commission to consider the following reforms to better regulate the role that proxy advisory firms play in the marketplace and provide more effective oversight of their business.

**I. Amend or Supplement Release No. IA-2106 to Clarify Investment Advisers' Obligations Under Rule 206(4)-6**

SEC Rule 206(4)-6 requires that investment advisers adopt policies and procedures to ensure that they are making proxy voting decisions in their clients' best interests. A key concern in making this determination is how the adviser addresses any material conflicts that may divide their interests from

---

<sup>1</sup> *National Compensation Survey: Employee Benefits*. Bureau of Labor Statistics, March 2018.  
<https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table02a.pdf>.

<sup>2</sup> <https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf>.

those of their clients. Guidance in Release No. IA-2106 allows advisers to cleanse themselves of any potential conflicts of interest by relying on the voting recommendations of an “independent third party.” Though IA-2106 notes that the effectiveness of policies and procedures designed to mitigate potential conflicts “will turn on how well they insulate the decision on how to vote client proxies from the conflict,” many investment advisers nonetheless rely on proxy advisory firms that have substantial conflicts themselves. More clarity is needed on the guardrails around how investment advisers can utilize independent third parties in order to ensure that proxy voting decisions are made in the best interests of the middle-class Americans whose retirement accounts are at stake.

### ***Reinforce Investment Advisers’ Fiduciary Duty When Utilizing Proxy Firm Recommendations***

Most importantly, the SEC should clarify that reliance upon the recommendation of an independent third party is not sufficient, in and of itself, to avoid conflicts of interest and/or to fulfill an investment adviser’s fiduciary duty to its clients. Utilizing a third party may be one of the steps an adviser takes to avoid conflicts, but the ultimate evaluation as to whether a conflict arises (and thus whether an adviser’s fiduciary duty has been fulfilled) must be undertaken on an issuer-by-issuer and issue-by-issue basis. Reliance on a proxy firm that is itself conflicted would simply trade the adviser’s potential conflicts for the firm’s and thus not be effective in protecting an investor’s interests. Expanding the conflicts of interest language in Section II(A)(2)(b) of IA-2106 to clarify that an independent third party is not necessary to fulfill an investment adviser’s fiduciary duty, nor is it sufficient to do so absent complementary analysis that shows an issue-specific decision was made in the investor’s best interest, would provide more effective guidelines to investment advisers as they design their internal policies and procedures to avoid conflicts.

The SEC could also mandate that investment advisers relying on proxy advisory firms’ recommendations contractually require that the firms live up to the same fiduciary duty standard to which the advisers themselves are held. Such a step would ensure that all parties involved in deciding how an investor’s shares should be voted are guided by that investor’s best interests. It would also make clear to investors that their needs are the driving force behind decisions made with their money, as well as allow for effective oversight of proxy firms’ decision-making processes under the applied fiduciary duty standard.

It is important to note that the NAM does not believe that prohibitions on investment advisers’ use of proxy advisory firms or other third parties are necessary. Indeed, the institutional investors participating in the November roundtable made clear that proxy firm research is a vital facet of their decision-making process – and quality, conflict-free external advice that enables investment advisers to act in the best interests of their clients can only benefit Main Street investors. Manufacturers simply believe that investment advisers have a duty to ensure that the research and recommendations on which they rely actually help them avoid conflicted votes rather than introducing new conflicts.

### ***Clarify the Definition of “Independent Third Party”***

Within the framework of IA-2106, the SEC could also build out the definition of “independent third party” in order to give investment advisers better tests of a proxy firm’s independence. Clearer guardrails would enable investment advisers to make a more informed choice about whether and how to utilize a third party; these tests would also incentivize proxy advisory firms to make targeted reforms to their business model in order to maintain their investment adviser client base. For example, qualification as “independent” under IA-2106 could hinge on, among other things:

- Avoidance of conflicts of interest relevant to a given issuer or issue and appropriate mitigation of any conflicts that arise;
- Public disclosure of any conflicts of interest as well as clear communication of issuer- and issue-specific conflicts directly to the investment adviser; and

- Delivery of issuer- and issue-specific recommendations rather than a reliance on one-size-fits-all guidelines.

Alternatively, the SEC could consider removing mention of independent third parties from IA-2106 entirely. Such a modification would in no way prohibit investment advisers from engaging the services of a proxy firm (or other third party), nor would it prevent reliance on a third party from being one of the many potential policies and procedures that advisers could adopt in order to attempt to avoid conflicted voting decisions. It would, however, undercut the flawed presumption that conflict mitigation is a *de facto* offshoot of the investment adviser-proxy firm relationship – instead making clear that the decision to utilize a proxy firm to guide proxy votes would be subject to the same effectiveness test as any other conflict mitigation strategy.

### ***Improve Disclosure of Policies and Procedures Related to Third Party Influence***

In the event that an investment adviser utilizes a third party to help shape an investor's proxy votes, the adviser should take proactive steps to ensure that their clients have access to information that will allow them to fully understand the policies and procedures that led to any final voting decision. Rule 206(4)-6 requires that investment advisers “[d]escribe to clients [their] proxy voting policies and procedures;” expanding on this requirement, especially as it relates to reliance on third parties, would help prioritize investment advisers' fiduciary duty in their choice of proxy advisory firms and ensure that one-size-fits-all guidelines do not overtake well-reasoned, issue-specific voting decisions.

For example, many market participants have made clear that the voting infrastructure offered by the proxy firms is an invaluable client service. The NAM in no way wants to interfere with institutional investors' ability to utilize that infrastructure, but we do believe that institutions should disclose to their clients if and how they review their ballots before they are auto-cast by the proxy firms.

More generally, advisers should disclose what policies are in place to ensure that investors' best interests are represented throughout the decision-making process. For example, advisers should disclose whether the proxy firms on which they rely gave issuers sufficient time to review and respond to draft recommendations and, if not, why they are relying on a recommendation that could contain errors or misconceptions. Similarly, investment advisers should be required to disclose their “custom” voting policies to their clients, as well as to what extent their final votes aligned with proxy firm recommendations, so that investors can evaluate the degree to which a proxy firm's one-size-fits-all guidelines are being applied to their holdings. These sorts of disclosures would help investors better understand the relationship between investment advisers' fiduciary duty and the proxy firms' voting recommendations, as well as allow them to evaluate for themselves how effectively their votes are being cast.

### ***Make Clear That Investment Advisers Are Not Required to Vote Every Proxy***

In IA-2106, the Commission notes that it is *not* the case “that an adviser that fails to vote every proxy would necessarily violate its fiduciary obligations,” and, further, that “[t]here may even be times when refraining from voting a proxy is in the client's best interest.” Similarly, Staff Legal Bulletin No. 20 (SLB 20) envisages “proxy voting arrangements in which the adviser would not assume all of the proxy voting authority,” including instances where expending the time and resources to vote a proxy would not be in the client's best interest, agreements between client and adviser that the adviser will abstain from voting on all proxies or on certain types of proposals, and arrangements where the adviser always votes in favor of management or a particular shareholder proponent.

Despite this seemingly clear guidance, investment advisers nonetheless often feel pressure to vote on every issue in every proxy contest. This gives rise to a paradigm wherein many advisers institute

policies to vote every proxy despite a lack of internal resources or expertise necessary to fully evaluate each voting decision on a company-by-company basis. This may have been exacerbated, to some extent, by the 2004 no-action letters issued to ISS and Egan-Jones – which the SEC has now withdrawn.

The pressure to focus on ballot measures that do not impact long-term value creation for investors can distract advisers from the issues most important to investor returns and stretch their internal resources – forcing them to rely more heavily on proxy advisory firms. This increases costs and exacerbates issues with proxy firms by creating more opportunities for their inaccurate and conflicted recommendations to impact shareholders, despite the fact that SEC guidance has made clear that advisers do not have to vote every proxy in the first place. Any amendments to IA-2106 should continue to emphasize that investment advisers are always required to act in a client's best interests, including in situations where choosing not to exercise their proxy voting authority is the best choice for an investor.

## **II. Replace the 2004 ISS and Egan-Jones No-Action Letters With Guidance That Effectively Enforces Staff Legal Bulletin 20**

As we said in our October 30, 2018, comment letter in advance of the proxy roundtable, the no-action letters issued to ISS and Egan-Jones in 2004 largely allowed investment advisers to outsource their decision-making and voting power to the proxy advisory firms. Specifically, we noted that the no-action letters enabled investment advisers to ignore the firms' significant conflicts of interest even as they took steps to utilize the firms to mitigate their own conflicts and, more generally, entrenched proxy firms' place in the market and allowed their one-size-fits-all, non-transparent approach to corporate governance to flourish. As such, we called the SEC staff's decision to withdraw the no-action letters "an important first step toward restoring the primacy of a fund manager's fiduciary duty to protect investors' retirement savings."

As the SEC considers how best to replace the now-withdrawn no-action letters, the NAM encourages the Commission to look for ways to undergird SLB 20, which provides guidance on investment advisers' responsibilities in voting client proxies and utilizing proxy advisory firms. Though SLB 20 did not take the step of withdrawing or overriding the 2004 no-action letters when it was released in 2014, its guidance should prove useful for investment advisers considering proxy firms' impact on their voting decisions now that the letters have been withdrawn – especially if the key facets of SLB 20 are supported by additional rulemaking. For example, under SLB 20 investment advisers retaining a proxy firm are required to:

- "Ascertain, among other things, whether the proxy advisory firm has the capacity and competency to adequately analyze proxy issues;"
- "Consider...the robustness of [the proxy advisory firm's] 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;"
- "Adopt and implement policies and procedures that are reasonably designed to provide sufficient ongoing oversight of the [proxy advisory firm] in order to ensure that the investment adviser, acting through the [proxy advisory firm], continues to vote proxies in the best interests of its clients;"
- "Establish and implement measures reasonably designed to identify and address the proxy advisory firm's conflicts that can arise on an ongoing basis," and
- In the event of a material factual error impacting a recommendation, "take reasonable steps to investigate the error...and seek to determine whether the proxy advisory firm is taking reasonable steps to seek to reduce similar errors in the future."

Additional guidance or rulemaking underscoring these requirements would make clear that investment advisers have a substantial due diligence requirement when utilizing a proxy firm's

research and recommendations and underscore the need for reform on the part of the firms in order to meet these standards. Guidance or rulemaking could also clarify how the Commission plans to hold advisers to these standards going forward, as well as what options might be available for the adviser's clients to ensure that the due diligence requirements are upheld with regard to their investments.

The NAM believes that advisers could comply with SLB 20's requirement that they "identify and address the proxy advisory firm's conflicts" by verifying, on a case-by-case basis, that any given proxy firm recommendation is not poisoned by the firm's conflicts of interest. Similarly, we believe that investment advisers could require that proxy firms give issuers sufficient time to review and respond to draft recommendations in order to ensure they are "continu[ing] to vote proxies in the best interest of [their] clients" under SLB 20 – after all, a process that allows issuers to identify mistakes and provide alternate perspectives can only improve the quality of the final vote decision. Advisers could also, per the requirements to ascertain competency and to investigate errors, require that the firms take steps to confirm that they are not negligent in consistently making errors and misrepresenting company proposals – especially since a recent study found that there were 139 instances of factual errors, analytical errors, or serious disputes reported in supplemental proxy statements over the last three years alone.<sup>3</sup>

We also believe, as outlined in our previous comment letter, that a process that allows investment advisers to fulsomely evaluate proxy firm recommendations that have been contested by an issuer would support compliance with SLB 20. Such a process would allow for an issuer to respond to the recommendation and include their dissenting opinion in the proxy firm materials alongside the recommendation and an explanation of any significant errors or departures in methodology. In such a situation, an investment adviser would not fulfill its fiduciary duty to investors if it relies on a pre-existing automatic voting policy with the proxy firm; instead, it would be required to substantively evaluate the discrepancy between the firm's recommendation and the issuer's point of view and make an affirmative decision in the best interest of the investors whose funds it manages.

It is apparent that the market would benefit from clarity in the wake of the withdrawal of the ISS and Egan-Jones no-action letters. The SEC now has the opportunity to take steps to provide effective guidance around the requirements of SLB 20 in order to set clear guardrails for the investment adviser-proxy firm relationship and foreground both parties' obligation to enhance long-term shareholder value for Main Street investors.

### **III. Amend the Exemptions to the Proxy Solicitation Rules to Require Reforms on the Part of Proxy Advisory Firms**

Proxy advisory firms rely on the SEC Rule 14a-2(b) exemptions from the proxy solicitation rules to avoid the Schedule 14A regulatory regime. Specifically, the firms qualify for an exemption under Rule 14a-2(b)(3), which states that the proxy solicitation rules do not apply to "[t]he furnishing of proxy voting advice" provided certain standards are met. The NAM supports clarifying and expanding the restrictions under Rule 14a-2(b) to ensure that proxy advisory firms furnish advice to institutional investors that is developed with the best interests of Main Street investors in mind.

Though the firms rely on the Rule 14a-2(b)(3) exemption, they nevertheless claim that such reliance is not technically necessary for them to avoid Schedule 14A because they are "contractually obligated" to provide their recommendations. Notably, ISS's letter to the Senate Banking Committee dated May 30, 2018, contends that providing proxy voting advice to clients does not constitute a solicitation in the first place, despite guidance to the contrary in SLB 20. This argument is

---

<sup>3</sup> Placenti, Frank M., *Are Proxy Advisors Really A Problem?* October 2018. [http://accfcorpgov.org/wp-content/uploads/2018/10/ACCF\\_ProxyProblemReport\\_FINAL.pdf](http://accfcorpgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf).

disconnected from the fact that proxy firm analysis has become an integral part of the regulated solicitation process, as well as the safe harbors the SEC has previously recognized for investment advisers' reliance on the firms' "independent" analysis. SEC clarification that the furnishing of proxy voting advice as practiced by proxy firms does indeed qualify as proxy solicitation – thus necessitating a reliance on an exemption – is clearly needed to rectify this misperception.

Furthermore, though the firms' contractually obligated voting recommendations are clearly solicitations, none of the Rule 14a-2(b) exemptions were specifically designed with proxy firms in mind, including the exemptions discussed in SLB 20. Given the firms' need to rely on an exemption, modifications to Rule 14a-2(b) to specifically cover contractually obligated solicitations would ensure the exemptions are working properly.

Amendments to the proxy solicitation exemptions should address the key structural flaws endemic to the proxy firms' business model – namely, their one-size-fits-all policies, lack of transparency, propensity for errors, misleading assumptions about key benchmarks like peer groups, lack of dialogue with issuers, problematic robo-voting policies, and significant conflicts of interest. The SEC should amend Rule 14a-2(b)(3) (or create a new exemption) to provide an exclusive safe harbor for contractually obligated solicitations. Any such safe harbor should condition proxy firms' reliance upon the exemption on the following requirements:

- Proxy firms should allow all issuers, not just the largest companies, access to draft recommendations. Currently, one of the two leading firms only provides draft reports to companies in the S&P 500, while the other charges issuers a fee to review recommendations; going forward, productive engagement with all issuers should be the norm.
- Proxy firms should give issuers sufficient time to review draft recommendations. A review period of at least five business days would provide for enough time for companies to spot mistakes, correct misunderstandings, and proactively engage with their investors.
- Proxy firm reports should include an issuer's dissenting opinion explaining the reasoning behind management's preferred course of action and/or highlighting errors in the firm's report in the event a recommendation is contested. Proxy firms would be under no obligation to modify any recommendation; the dissenting opinion would simply give investors additional information from the company's perspective.
- Proxy firms should be required to justify any significant departures in methodology (e.g., differences in determining peer group, disclosed compensation, or other key business metrics) that lead to discrepancies between the firm's understanding of an issue and the company's stance, as well as explain the reasoning for the application of any one-size-fits-all guidelines that may not be appropriate to evaluate a given issuer.
- Proxy firms should be required to publicly disclose any conflicts of interest to make clear to the entire marketplace the incentive structure underlying the firms' recommendations on any given issuer. This public disclosure would be complemented by individual conflicts disclosures (related to specific issuers or individual ballot measures) on the proxy reports disseminated to investment advisers.
- Proxy firms should disable any default vote settings in the event that a recommendation is contested by an issuer. This would prevent automatic votes on contentious issues (while smoothing the process on non-contested issues) and instead allow an investment adviser time to make a considered decision by weighing the relative merits of the firm's recommendation and a company's dissenting opinion. Once an affirmative decision is

reached, the adviser could confirm the choice with the proxy firm and the vote would be cast accordingly.

Providing an exclusive safe harbor by making these commonsense reforms to Rule 14a-2(b)(3) (or by providing for a new exemption under Rule 14a-2(b)) would incentivize the proxy advisory firms to make the internal changes necessary to improve accuracy, enhance transparency, and address conflicts of interest. Furthermore, such a safe harbor would provide clear guidance to investment advisers relying on proxy firms as “independent” third parties under IA-2106 as to the standards to which the firms should be held. Ultimately, clarifying and expanding Rule 14a-2(b) would lead to significant improvements in the breadth and quality of information available to investment advisers and ensure that the advisers and the firms both clearly understand the regulatory paradigm in which the firms operate.

#### **IV. Require Proxy Advisory Firms to Register With the SEC**

The NAM believes that the SEC can make significant progress toward effective oversight of proxy advisory firms via the targeted reforms to the existing regulatory regime discussed above. However, the Commission also has the statutory authority to consider a more direct approach to proxy firm reform: registration with the Commission, as envisioned by the Corporate Governance Reform and Transparency Act. Requiring proxy advisory firms to register with the SEC would allow the Commission to set metrics related to conflict mitigation, transparency, responsiveness, and accuracy and make registration contingent upon a proxy firm’s compliance with the published standards. As the SEC contemplates how best to make reforms that reduce proxy firms’ outsized influence and emphasize all market actors’ fiduciary duty to America’s Main Street investors, it should continue to give careful consideration to all policy solutions it has the authority to implement – including a registration regime.

\* \* \* \*

The NAM applauds the SEC for considering the role that proxy advisory firms play in America’s capital markets and how targeted reforms and effective oversight can reduce the firms’ influence and reinforce investment advisers’ fiduciary duty to Main Street investors. We encourage the SEC to take concrete action to address these issues, and we look forward to working with you to ensure that America’s public markets continue to support the growth of manufacturers in all 50 states.

On behalf of the NAM and the 12 million men and women that make things in America, thank you for your attention to these concerns.

Sincerely,



Chris Netram  
Vice President, Tax & Domestic Economic Policy