Mr. Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
via SEC internet submission form

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

Dear Mr. Fields,

I am Associate Professor of Law at the Antonin Scalia Law School, George Mason University, and spent two years as Chief Economist and Senior Counsel for the U.S. House Committee on Financial Services.[1] I also serve on the SEC's Investor Advisory Committee. In that capacity, I welcome the opportunity to contribute to the Securities and Exchange Commission's (SEC) Roundtable on the proxy process. Throughout my career, as both an academic and professional, much of my research and work has focused on corporate and securities law and financial regulation.

I am writing to provide additional comment regarding the SEC's consideration of issues raised during its recent roundtable on the proxy process. I provided a prior comment letter in this file.[2]

This updated comment letter summarizes the results of a survey of retail investors in which they were asked directly for their views about issues raised in the debate over proxy advisory firms. The full report is included as an Appendix to this comment letter.

This comment letter also demonstrates how the results of that survey further now lend strong support to the policy recommendations I offered in my last comment letter.

I. Proxy Process Reform is Focused on Main Street Investors

The SEC has initiated a deliberative process to consider improvements to the proxy voting landscape. In the first roundtable on the proxy process, Chairman Clayton set the tone for these discussions by asking: "who are we improving it for? I believe the answer is our long-term Main Street investors. I hope you will approach these

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[1] In the interest of disclosure, I serve on the board of directors of a firm that provides proxy advisory services, Egan-Jones. I do not speak on their behalf but only for myself in my role as an academic.
[2] See Verret Comment Letter, available at https://www.sec.gov/comments/4-725/4725-4595389-176341.pdf.

important issues them in mind – those who have put or are putting $50, $100, $200 a month away for years and years."[3]

Along that theme, when the Chairman initiated the shareholder voting roundtables he request that commenters help the Commission examine the gap between retail shareholder and institutional shareholder voting participation. He specifically noted:

> In the 2017 proxy season, retail shareholders voted approximately 29% of their shares, while institutional investors voted approximately 91% of their shares. In this regard, it may be useful to better understand: Reasons for this relatively low retail participation rate and whether better communication and coordination among proxy participants, increased use of technology, changes to our rules, or investor education could increase participation.[4]

Many commenters to the proxy roundtable asserted their positions were provided on behalf of retail shareholders, either as beneficiaries of their pensions or as investors in their funds. For example, the New York Comptroller asserted his comments on the proxy process were provided pursuant to his duty to "more than one million state and local government employees, police officers and firefighters, retirees and beneficiaries."[5]

A letter from the Ohio State retirement system similarly noted: "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… 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."[6]

In its comment letter to the SEC proxy roundtable, the largest proxy advisor ISS asserted the following:

> 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

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[3] Chairman Jay Clayton, Statement at the SEC Staff Roundtable on the Proxy Process, Nov. 15, 2018, available at https://www.sec.gov/news/public-statement/clayton-statement-roundtable-proxy-process.

[4] 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

[5] Comment letter of Thomas P. DiNapoli, New York State Comptroller, https://www.sec.gov/comments/4-725/4725-4646620-176466.pdf, at 1.

[6] Comment Letter of Ohio Public Employees Retirement System, https://www.sec.gov/comments/4-725/4725-4767821-176841.pdf, at 1.

> institutional investors. In addition, many U.S. households participate in the capital markets by investing in mutual funds. In this way, retail investors are ultimately the beneficiaries of the critical work that ISS does for its institutional clients.[7]

Indeed, nearly all of the commenters who defended the two largest incumbents in the proxy advisory industry and argued the Commission should take no action with respect to proxy advisors asserted their position was taken on behalf of retail investors or retail beneficiaries.

This letter summarizes the findings from a survey of retail investors, including individuals accessing the capital markets through various means from pension fund beneficiaries to private retirement accounts. It summarizes their views related to some of the issues being debated in the proxy reform discussion. The survey places particular focus on two interrelated issues in proxy reform: shareholder proposals on the corporate ballot and the proxy advisory firms who provide voting recommendations to mutual funds about those recommendations.

Opponents of proxy advisor reform or shareholder proposal reform assert the risk that a vital underpinning of management accountability to shareholders will be harmed. The Council of Institutional Investors asserted in their comment letter to the proxy roundtable that:

> Proxy voting is a critical means by which shareowners hold corporate executives and boards to account and is a hallmark of shareholder ownership and accountability. The system of corporate governance in the United States relies on the accountability of corporate officers and boards of directors alike to shareowners, and ensuring unencumbered shareholder access to independent research is a crucial underpinning of effective corporate governance.[8]

This survey is the first to reach out to these retail shareholders and determine their own preferences on these matters. The findings in the survey suggest that retail shareholders are too often being used as a poster child by institutional intermediaries to support practices in shareholder voting they retail shareholder do not support. To the contrary, retail investors often make a rational determination that shareholder voting is not a cost effective means to discipline managers. This may reflect their determination that simply selling their shares is a more effective response to governance problems at the firm.

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[7] Institutional Shareholder Services Comment Letter, available at https://www.sec.gov/comments/4-725/4725-4629940-176410.pdf, at 5.

[8] Council of Institutional Investors Comment Letter, available at https://www.sec.gov/comments/4-725/4725-4630831-176413.pdf , at 14.

At times retail shareholders are being used in support of practices they directly disagree with or about which they are agnostic as providing little value to them directly. This survey demonstrates that retail shareholders are not the true impetus for many of the voting practices highlighted in the proxy roundtable. Indeed, contrary to popular perception the shareholder proposal process is not a grass roots initiative by many shareholders working to hold management accountable.

Instead, the shareholder proposal process is highly concentrated and consists of a small number of shareholder filers. Proxy Monitor found that in 2017 "A limited group of shareholders has submitted the overwhelming majority of shareholder proposals. Just three individuals and their family members sponsored 25% of all proposals."[9] Thus it would appear that a small number of conflicted parties may be using low retail shareholder voting interest or participation to leverage their influence in ways that run directly contrary to the preferences of those shareholders.

The next section will summarize the results of a retail investor survey to shine additional light on these issues.

II. Findings from A Survey of Main Street Investors

Demographics

The survey respondents report that 61% have a defined contribution plan, 21% have a managed or advisory account, 57% also have an IRA. The largest group at 37% (1925 respondents) report between $10,000 and $100,000 in investments. 36% report between $100,000 and $500,000 in investments. The largest group of respondents at 35% are between 35 and 54, and 25% of respondents were over 65. Additional demographic data is provided near the end of the survey results which reflect that the survey participants are a fair representative sample of the retail investor community.

Survey Results: Retail Investor Preferences & Their Relevance for Commission Action

The respondents were asked "In terms of your investment preferences, given the choice between maximizing returns and pursuing other social or political objectives, how would you rate your prioritization" on a scale of 0-100, with 100 representing fully maximizing returns. 91% of respondents provided values higher than 50, only 8% provided values lower than 50. The mean value was 76.3% and the median value was 79% (is this accurate?).

This suggests that in instances in which shareholder wealth maximization and social responsibility goals are in conflict, the retail investor community leans strongly

[9] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.

toward wealth maximization. This suggests Commission attention to the role of ESG proposals in shareholder voting and proxy advisor recommendations directly serves the interests of retail investors.

Respondents were asked before the survey and after the survey whether they supported SEC efforts to increase oversight and regulation of the proxy advisor industry. This permitted a survey of respondent preferences prior to starting the survey, and allowed a second view of respondent preferences after learning the basic issues involved over the course of the survey. Survey questions are provided in an attachment.

Pre-survey, 23% of respondents fully supported additional oversight, post-survey that number grew to 37%. Pre-survey and post-survey a majority of respondents express either full, moderate, or slight support for added oversight. Total respondents expressing some amount of support for increased oversight increased from 65% pre-survey to 83% post-survey.

Not only did a majority of respondents support additional oversight of proxy advisors before learning new information over the course of the survey, but as they learned additional information about the particular concerns raised during the roundtable about proxy advisors their interest in additional regulation grew.

Only 3% of respondents expressed no support for added oversight pre-survey, and 1% expressed no support post-survey. 32% of respondents did not know their preference pre-survey, but only 16% of respondents did not know their preference post-survey. 59% of respondents were either very, somewhat, or slightly informed about shareholder proposals. 51% of respondents were similarly informed about proxy advisory firms.

This suggests that the overwhelming majority of retail investors disagree with the views of ISS and many pension funds who suggested the SEC should make no changes to its oversight of proxy advisors. The fact that these institutional fiduciaries would ignore the concerns of retail shareholders, for whom these groups purport to speak, suggests they may be failing in their fiduciary obligations to the retail investor community.

Only 48% of respondents, 2412, had ever voted their shares, though 67% expressed some level of interest in voting their shares in future meetings. When determining how to vote shares, 59% utilize the proxy statement, 43% conduct their own research, 24% consider financial media discussion of the issues, and only 14% purchase proxy reports from a proxy advisor.

28% reported that having a choice in how their shares are voted is very important, 33% reported that it was only moderately important, 23% suggested it was only slightly important, and 7% suggested it was not important at all. 48% responded they wanted more information from asset managers on how shares are voted, only 31% suggested current vote disclosure by asset managers was sufficient.

This result is consistent with the notion that retail shareholders don't tend to see active voting as beneficial. At the same time, when made aware of the potential that shareholders may be voted on their behalf in ways that conflict with their interest by asset managers, retail investors would like additional disclosure.

39% and 38% of respondents reported that additional investor education about the proxy process and better communication among proxy participants would increase their likelihood of participation in proxy voting. This demonstrates that the SEC's roundtables on the proxy process have been constructive and that further education on these issues through the SEC's Office of Investor Education and Advocacy can increase the extent of shareholder voting participation.

36% of participants expressed some familiarity with the dominant proxy advisory firm, ISS. 24% expressed some familiarity with the second largest proxy advisor, Glass Lewis. When told that some have expressed concerns that ISS and Glass Lewis represent a duopoly in the market that limits new competitor entrants, an overwhelming 74% of respondents expressed some level of concern.

While it would not be appropriate for the SEC to directly regulate the market share of proxy advisory firms, this does suggest retail investors would welcome Commission attention to rules which may entrench the dominant position of these firms as well as attention to conflicted advisory fees that further cement the dominant position of ISS in the market.

When informed that ISS both provides proxy recommendations about companies and also offers consulting serves to those same issuers, 82% of retail investors expressed some level of concern. 45% of respondents expressed that ISS should both disclose where they provide both recommendations and consulting and should also fully disclose how they mitigate conflicts of interest.

When informed that Glass Lewis is co-owned by the asset manager for a union pension fund that also submits ESG proposals, 73% expressed concern that the ESG policies of its parent company would influence Glass Lewis's proxy recommendations. 80% of respondents supported SEC action to address conflicts of interest with respect to proxy advisors.

The survey solicited feedback on particular issues with proxy advisors that were raised by participants at the SEC's first roundtable on the proxy process. A majority of respondents supported SEC action to address conflicts of interest, robo-voting, transparency, errors, and to provide issuers with an opportunity to respond to adverse proxy recommendations. The two issues of greatest concern to respondents (from among those expressed at the roundtable) were that proxy advisors refuse to engage issuers and enable robo-voting.

77% of respondents supported SEC action to address robo-voting. The largest share of respondents (21%) responded that a voting rate of 50% or more in line with proxy advisor recommendations was inappropriate for asset managers.
84% of respondents supported SEC action to improve transparency in proxy advisors. 81% of respondents offered some level of support for Commission action to address the problem of errors in proxy advisor recommendations.

78% of respondents expressed some level of concern when presented with a study suggesting that Glass-Lewis did not provide issuers with an opportunity to comment on proxy recommendations in 84% of adverse recommendations. When asked how much time issuers should be granted to review proxy advisor recommendations and remedy potential errors, the largest share of respondents (28%) suggested an appropriate period of time to be between 1-2 weeks. 77% of respondents expressed some level of support for the SEC addressing the concern that proxy advisors fail to engage with issuers.

The survey provides a rich resource for the Commission to draw from in considering the issues raised during the proxy roundtable for possible future regulatory reform in this area.

III. Recommendations for Action

Conflicts of Interest at Proxy Advisors

If ISS and Glass-Lewis were conflict free, offered robust recommendations based on increasing shareholder value, and did not obtain demand for their services in part through regulatory pressure, then there would be little reason for the Commission to take action on these issues. Unfortunately that is not the case.

Conflicts of interest at the two dominant firms in the proxy advisory industry manifest themselves in two primary ways. The first–more subtle–conflict is the influence of proxy advisors' clients on the recommendations issued. Substantial income is provided by 'socially responsible' investing funds to proxy advisors, which are, in turn, incentivized to favour proposals that are backed by these clients. When retail investors are apprised of this problem, they strongly demanded responsive action from the Commission

The current dynamic for proxy advisors deviates from a focus on shareholder value, generating private benefits to a subset of investors at the expense of the average diversified investor. This has implications for another of the Roundtable's areas of focus, the role of shareholder proposals in the proxy process. In effect, proxy advisors have been granted the ability to wield the aggregate influence of all their clients to the benefit of a particular type of investor.

The second–more obvious–conflict that exists in the proxy advisory industry is the provision of consulting services to the same issuers about which recommendations are issued to investors. The implicit threat of receiving a negative recommendation from ISS is a cornerstone of the offering from that same company to publicly listed companies.

There are analogous concerns over conflicts of interest in other areas of financial services, particularly those stemming from the provision of consulting services. The investment community itself (including the Council for Institutional Investors and California Public Employees' Retirement System) has been steadfast in arguing against the provision of consulting services by a company's external auditor. A proxy advisor simultaneously providing governance advisory services and recommendations is akin to an auditor providing an issuer with guidance on how to navigate an external audit.

The retail investor survey shows that retail investors do not take the same "see no evil, hear no evil" approach to conflicts of interest at proxy advisory firms, but instead quickly see the case for addressing conflicts of interest at proxy advisors and would welcome Commission action to address this issue. While additional disclosure about conflicts of interest may prove helpful, the substantial market power prior Commission action has given to ISS suggests prohibition of conflicted consulting provision by proxy advisors may be warranted.

Proxy Advisor Disclosure

The objective of corporate governance is the enhancement and protection of shareholder value; however, it remains unclear what role shareholder value plays in the processes and methodologies of proxy advisors. In fact, the evidence appears to point to the contrary, with a lack of capacity and capability, conflicts of interest and ideological bias resulting in proxy advisor recommendations by ISS and Glass-Lewis depleting shareholder value.

The retail investor survey shows that the social and political focus of many proxy advisory firms is inconsistent with the shareholder return focus of most retail investors. Further, many investors are eager for disclosure about how these conflicts on interest may be impacting their portfolios.

In two separate Stanford studies[10], researchers found that the recommendations of ISS negatively impact shareholder value, with investors better off if they were to

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[10] David F. Larcker, Allan L. McCall, and Gaizka Ormazabal, "The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policy" (Rock Center for Corporate Governance at Stanford University Working Paper No. 119, Stanford, CA, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id= 2101453. David Larcker, "Do ISS Voting Recommendations Create Shareholder Value?" (Rock Center for Corporate Governance at Stanford University, Closer Look Series: Topics, Issues and Controversies in Corporate Governance and Leadership No. CGRP-13, Stanford, CA, April 19, 2011): 2, http://papers.ssrn .com/sol3/papers.cfm?abstract_id=1816543##.

ignore ISS. ISS also promulgates other corporate governance policies for which the empirical evidence is mixed, at best, including the right to nominate director candidates to the corporate proxy[11], options repricing[12], independent chairs[13] and Golden Parachutes.[14] While these policies are certainly favoured by politically minded institutional investors – ISS's largest clients – they are not clearly linked to the enhancement of shareholder value and thus stronger returns to the ultimate beneficiaries of mutual funds.

In many ways, it would be unreasonable to expect the two dominant proxy advisors to be effective in providing accurate and nuanced corporate governance advice to investors. ISS's website states that it covers over 42,000 meetings a year for a client base in excess of 1,700, while Glass Lewis produces analysis on over 20,000 companies.

With over half of US AGMs taking place in a three-month period, both advisors must by necessity put in place rigid methodologies in order to produce the volume of reports they do. The problem with rigid methodologies is that they simplify the complexities of business reality and do not allow for case-by-case appraisals of company practices and disclosure.

The inability of the two dominant proxy advisors to offer company and circumstance-specific recommendations and the limited empirical evidence supporting those recommendations calls into question whether ERISA and mutual fund fiduciaries are fulfilling their obligations in relying on the proxy advisor advice of ISS and Glass-Lewis.

Disclosure can only help shine the light on what proxy advisors are actually delivering. Retail investors may have the right idea…fewer votes and on wasteful ballot issues may be the right approach. In which case, intermediary institutions will have less need for proxy advisors, particularly when the dominate players in this industry are motivated by conflicts that run counter to the interests of most retail investors.

Clarification of Fund Fiduciary Duties With Respect to Share Voting

While there are times where active share voting can generate value for investors, it is not clear that is always the case system wide. Institutional Investors should have

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[11] See Thomas Stratmann and J.W. Verret, "Does Shareholder Proxy Access Damage Share Value in Small Publicly Traded Companies?," Stanford Law Review 64 (2011): 1431–68.

[12] The debate over whether options repricing is material to executive compensation packages is explored in Brian J. Hall and Thomas A. Knox, "Underwater Options and the Dynamics of Executive Pay-to-Performance Sensitivities," Journal of Accounting Research 42, no. 2 (May 2004): 365–412.

[13] See generally Roberta Romano, Foundations of Corporate Law, 2nd ed. (New York: Thomson Reuters/Foundation Press, 2010) 410–25

[14] See generally Richard A. Lambert and David F. Larcker, "Golden Parachutes, Executive Decision Making and Shareholder Wealth," Journal of Accounting and Economics 7 (1985).

an option to establish a default voting process that votes with the management slate absent some clear red flag suggesting further inquiry is necessary. Based on the SEC's current guidance, it is not clear the institutional investors could establish such a policy. The SEC could remedy that problem with a change in its mutual fund voting guidance.

The Commission observed in its original release that "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." While it would appear the Commission is indicating it does not require active voting by mutual funds, in fact the adopting release taken as a whole suggests a presumption in favor of active voting management, with the burden on funds to show that active voting is not beneficial.

This presumption was adopted despite the fact that so many voting contests simply cannot generate company value. For example, the overwhelming majority of company contests are uncontested. Even shareholder votes newly mandated by the Dodd-Frank Act appear to be largely irrelevant, as 98.6% of all pay votes are approved and 99.8% of uncontested elections do not result in majority withhold votes.[15]

A large percentage of shareholder proposals, on which proxy advisors provide recommendations, are defeated. Indeed in 2017 only 5% of all shareholder proposals received a majority vote of support, 95% of them were rejected.[16]

The SEC should elaborate on language in its original adopting release to swap the presumption in favor of active voting by management to instead permit fund managers to refrain from voting unless it is clearly demonstrated that the benefits of actively voting exceed costs. It should instead explicitly permit funds to adopt voting policies that reflect the lack of value in many voting contests. Funds should be able to adopt policies that eschew voting in general, in instances of shareholder proposals, or adopt policies tailored to vote with management unless red flags listed by the fund's management are triggered (such as a recent restatement).

The Commission should also make clear that if fund managers adopt voting policies intended to further political or social causes important to the fund's managers or controlling shareholder that have not been shown to enhance shareholder value, those funds may violate their fiduciary duties to the fund.

These conflicts could be manifested in many ways, including informal pressure during board elections or merger approvals. The most direct way they appear is via

[15] Council of Institutional Investors Comment Letter, available at https://www.sec.gov/comments/4-725/4725-4630831-176413.pdf , at 15.
[16] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.

shareholder proposals, most of which are fairly characterized as displays of personal political or social policy preferences with little relationship to shareholder value. Proxy Monitor observes that "proposals related to social or policy concerns with a limited relationship to share value constituted 56% of all shareholder proposals in 2017."[17] Proxy Monitor tracks that from 2006 through 2015, companies received 1,347 shareholder proposals related to social or political matters, none of which received a majority of shareholder support.[18]

IV. Conclusion

The investor survey presented in this comment shows a wide gulf between the expectations of the retail investor community on the one hand, and institutional investors and proxy advisors who purport to act on their behalf. Conflicts abound in the proxy advisor industry that exacerbate that gulf. The SEC's important work in this area can help to alleviate that gulf. The survey summarized in this comment is the first time retail investors have been engaged directly, a rare opportunity to hear directly from the ultimate stakeholders on proxy voting. This survey offers powerful evidence to inform future SEC action on proxy process reform, particularly with respect to issues posed by conflicted proxy advisors.

[17] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.
[18] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.

Appendix A: Report of Spectrem Group

Contents

Introduction – by J.W. Verret

The results of an extensive survey of 5,159 retail investors points to a growing disconnect between the expectations of those everyday investors and the increasing influence of proxy advisors, companies that provide voting services to the investment firms managing retail investor money. The survey presented here directly asks retail investors about issues raised in the debate over proxy advisory firms, revealing retail investors' level of concern with fundamental flaws in the proxy advisor industry, including, but not limited to, conflicts of interest, robo-voting and insufficient transparency.

The increased focus of fund managers and proxy advisors on political and social activism, rather than maximizing returns, is out of sync with the expectations of ordinary investors. This practice has the potential to negatively impact returns for all retail investors by increasing the burden on public companies with no clear link to shareholder value. The absence of the inclusion of retail investors in the proxy process – as demonstrated by the participation levels and their inability to influence institutional shareholder voting – means that the voice of retail investors, who own 30 percent of public corporations in the United States, is being drowned out.

I. Proxy Process Reform is Focused on Main Street Investors

The U.S. Securities and Exchange Commission (SEC) has initiated a deliberative process to consider improvements to the proxy voting landscape. In the first roundtable on the proxy process, Chairman Jay Clayton set the tone for these discussions by asking: "Who are we improving it for? I believe the answer is our long-term Main Street investors. I hope you will approach these important issues with them in mind – those who have put or are putting $50, $100, $200 a month away for years and years."[19]

When the Chairman later initiated the shareholder voting roundtables in November 2018, he requested that commenters help the Commission examine the gap between retail shareholder and institutional shareholder voting participation. He specifically noted:

> "In the 2017 proxy season, retail shareholders voted approximately 29 percent of their shares, while institutional investors voted approximately 91 percent of their shares. In this regard, it may be useful to better understand: Reasons for this relatively low retail

[19] Chairman Jay Clayton, Statement at the SEC Staff Roundtable on the Proxy Process, Nov. 15, 2018, available at https://www.sec.gov/news/public-statement/clayton-statement-roundtable-proxy-process.

participation rate and whether better communication and coordination among proxy participants, increased use of technology, changes to our rules or investor education could increase participation."[20]

Given this increased focus, the survey briefly explores voter participation. The survey found that 42 percent of retail investors reported that additional investor education about the proxy process would increase their likelihood of participating in proxy voting, and 40 percent indicated that they desire better communication. This confirms that the SEC's roundtables on the proxy process have been constructive and that further education on these issues through the SEC's Office of Investor Education and Advocacy can increase the extent of retail shareholder voting participation.

Many commenters to the proxy roundtable asserted their positions were provided on behalf of retail shareholders, either as beneficiaries of their pensions or as investors in their funds. For example, the New York Comptroller asserted his comments on the proxy process were provided pursuant to his duty to "more than one million state and local government employees, police officers and firefighters, retirees and beneficiaries."[21]

A letter from the Ohio Public Employees Retirement System (OPERS) similarly noted: "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… 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."[22]

In its comment letter to the SEC proxy roundtable, Institutional Shareholder Services (ISS), the largest proxy advisor, asserted the following:

> "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. In this way, retail

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[20] 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
[21] Comment letter of Thomas P. DiNapoli, New York State Comptroller, https://www.sec.gov/comments/4-725/4725-4646620-176466.pdf, at 1.
[22] Comment Letter of Ohio Public Employees Retirement System, https://www.sec.gov/comments/4-725/4725-4767821-176841.pdf, at 1.

investors are ultimately the beneficiaries of the critical work that ISS does for its institutional clients."[23]

Indeed, nearly all of the commenters who argued on behalf of the two major proxy advisors (ISS and Glass Lewis), recommended the Commission take no action with respect to the proxy advisor industry on behalf of retail investors or retail beneficiaries.

This report summarizes the findings from a comprehensive survey of retail investors – including individuals accessing the capital markets through various means, from pension fund beneficiaries to private retirement accounts – and summarizes their views related to some of the issues being debated in the proxy reform discussion. The survey places particular focus on the level of awareness, concern and support for SEC oversight of the proxy advisory firms that provide critical voting recommendations to investment firms on shareholder proposals.

Opponents of proxy advisor reform or shareholder proposal reform assert the risk that a vital underpinning of management accountability to shareholders will be harmed. The Council of Institutional Investors asserted in their comment letter to the proxy roundtable that:

> "Proxy voting is a critical means by which shareowners hold corporate executives and boards to account and is a hallmark of shareholder ownership and accountability. The system of corporate governance in the United States relies on the accountability of corporate officers and boards of directors alike to shareowners, and ensuring unencumbered shareholder access to independent research is a crucial underpinning of effective corporate governance."[24]

This survey is the first to bring these questions to retail shareholders and uncover their views. The findings in the survey indicate that retail shareholders are too often being used as a poster child by institutional intermediaries to support practices in shareholder voting that retail shareholders do not support. To the contrary, retail investors often make a rational determination that shareholder voting is not a cost-effective means to discipline managers. This may reflect their determination that simply selling their shares is a more effective response to governance problems at the firm.

At times, retail shareholders are being used in support of practices with which they directly disagree, or about which they are agnostic, as they feel the practices offer

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[23] Institutional Shareholder Services Comment Letter, available at https://www.sec.gov/comments/4-725/4725-4629940-176410.pdf, at 5.
[24] Council of Institutional Investors Comment Letter, available at https://www.sec.gov/comments/4-725/4725-4630831-176413.pdf , at 14.

little direct value to them. This survey demonstrates that retail shareholders are not the true impetus for many of the voting practices highlighted in the proxy roundtable. Indeed, contrary to popular perception, the shareholder proposal process is not a grassroots initiative by many shareholders working to hold management accountable.

Instead, the shareholder proposal process is highly concentrated and consists of a small number of shareholder filers. Proxy Monitor found that in 2017, "A limited group of shareholders has submitted the overwhelming majority of shareholder proposals. Just three individuals and their family members sponsored 25 percent of all proposals."[25] Thus, it would appear that a small number of conflicted parties may be using low retail shareholder voting interest or participation to leverage their influence in ways that run directly contrary to the preferences of those shareholders.

The next section will summarize the results of a retail investor survey to shine additional light on these issues.

About J.W. Verret

Associate Professor J.W. Verret joined the law faculty in 2008 and teaches courses on banking, securities and corporation law, as well as accounting for lawyers.

Having also been a Visiting Professor at Stanford Law School, Mr. Verret's work teaching CLEs on law and accounting at law firms around the country was profiled by Above the Law at this link.

Mr. Verret frequently serves as an expert witness in securities, corporate and commercial litigation and arbitration proceedings. A few representative engagements include New Jersey v. Sprint, 758 F.Supp.2d 1186 (2010) and Landsdowne v. OpenBand, 713 F.3d 187 (2013).

He serves on the SEC's Investor Advisory Committee, where he advises the Chairman of the SEC on legal and policy reform. He is faculty liaison to the American College of Business Court Judges. He also serves as Independent Chairman of the Board of Directors of Egan-Jones Ratings, one of the eight domestic credit rating firms licensed by the SEC to provide credit ratings on the debt of public companies, where he provides recommendations on shareholder proxy votes.

Mr. Verret has served as Chief Economist and Senior Counsel to the U.S. House Committee on Financial Services. He previously clerked on the Delaware Court of Chancery. He received his JD from Harvard Law School, a master's degree in public

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[25] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.

policy from the Harvard Kennedy School and a bachelor's degree in financial accounting from Louisiana State University.

Mr. Verret's work as appeared in publications ranging from the *Stanford Law Review* and *Journal of Law and Economics* to the *Wall Street Journal* and *New York Times*. He has appeared on most major television networks, commenting on financial regulatory issues, and has testified before the U.S. House and Senate more than a dozen times.

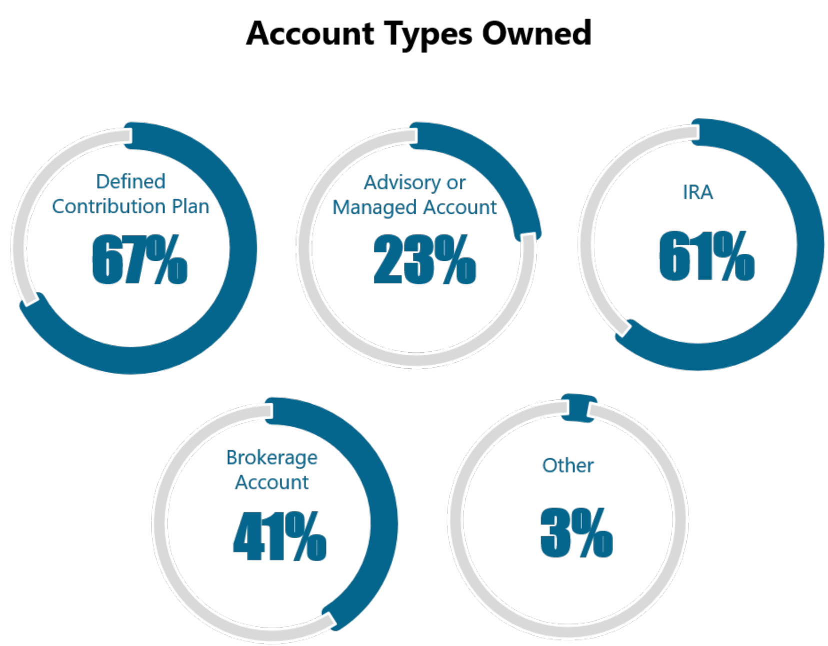
About Spectrem Group

Spectrem Group is the leading provider of market research, consulting and content in the wealth management and retirement markets. Spectrem Group strategically analyzes its ongoing primary research with investors to assist financial providers and advisors in understanding the Voice of the Investor.

Demographics

The survey was fielded through an online survey between Feb. 14 and March 1, 2019. Respondents have at least $10,000 of assets in any combination of stocks, bonds, mutual funds and exchange-traded funds (ETFs) held in various types of accounts, such as defined contribution plans (such as 401k), advisory accounts, brokerage accounts, individual retirement accounts (IRAs) and other similar investment accounts. Respondents are at least 19 years of age, and fielding was conducted to mirror the age distribution of the overall United States population over the age of 19.

A total of 5,159 persons qualified and responded to the survey. Of all respondents contributing to the sample, 67 percent have a defined contribution plan, 23 percent have a managed or advisory account and 61 percent have an IRA.



All survey data, including detailed demographic data, is provided on the Spectrem website and is available for public consumption.

Key Observations by J.W. Verret

Retail Investor Preferences & Their Relevance for Commission Action

Retail Investors Prioritize Investment Returns

In instances where shareholder wealth maximization and social responsibility goals are in conflict, the retail investor community leans strongly toward wealth maximization. This suggests that Commission attention to the role of environmental, social and governance (ESG) proposals in shareholder voting and proxy advisor recommendations directly serves the interests of retail investors. This concern was shared by Commissioner Peirce in a recent speech to the Council of Institutional Investors.[26]

- **Key Data Point:** 91 percent of retail investors indicated a preference for wealth maximization over political/social objectives**.**

Retail Investors Support SEC Oversight of Proxy Advisors

Respondents were asked both before and after the survey whether they supported SEC efforts to increase oversight and regulation of the proxy advisor industry. Prior to the survey, we found that nearly two-thirds of retail investors at least slightly support potential SEC oversight of proxy advisors. Of those that were informed on the issue, a much larger majority of respondents supported additional oversight of proxy advisors. The overwhelming majority of retail investors disagree with the views of ISS and many pension funds, who recommended that the SEC make no changes to its oversight of proxy advisors.

- **Key Data Point:** Prior to the survey, 64 percent of retail investors at least slightly supported SEC oversight of proxy advisors, while the other third didn’t know enough to have an opinion.
- **Key Data Point:** Of those that are very familiar with proxy advisors, 96 percent at least slightly supported increased SEC oversight.

Uninformed Investors Become Highly Supportive of Oversight with Education

As these respondents learned more information throughout the survey, we found that their level of support for oversight increased. Upon completion of the survey, which included industry context, we not only discovered that a large majority of investors support SEC oversight; we found that more than three quarters of investors became *more* supportive of SEC oversight. This highlights the critical roles of education and communication in informing retail investors.

- **Key Data Point:** Following the survey, 85 percent of retail investors at least slightly supported SEC oversight of proxy advisors.

[26] https://www.sec.gov/news/speech/speech-peirce-030519

- **Key Data Point:** 56 percent of retail investors changed their overall level of support during the survey, and 76 percent of those investors increased their level of support for SEC oversight of proxy advisors.

Largest Problems are Robo-Voting, Conflicts of Interest and Proxy Advisor Transparency

The survey solicited sentiment on individual issues with proxy advisors that were raised by participants at the SEC roundtable on the proxy process. A majority of respondents supported SEC action to address conflicts of interest, robo-voting, transparency, recommendation errors and the need to provide issuers with an opportunity to respond to adverse proxy recommendations. Outside of a clear preference for increased oversight, the two issues of greatest concern to respondents (of those expressed at the roundtable) were that proxy advisors refuse to engage issuers and enable robo-voting.

- **Key Data Point:** 84 percent of retail investors indicated robo-voting was at least a slight concern, and 79 percent of investors at least slightly supported SEC adoption of changes to address this issue.
- **Key Data Point:** Over 95 percent of retail investors indicated that remaining unbiased from conflicts of interest was important in proxy advisor recommendations.
- **Key Data Point:** 86 percent of retail investors indicated support of SEC oversight regarding inadequate proxy advisor transparency, specifically to address one-size-fits-all approaches.

Survey Results – by Spectrem Group

About the Research

In a statement released by SEC Chairman Jay Clayton, the Commission outlined specific proxy firm areas of concern, including "whether the extent of reliance on these firms is in the best interests of investment advisors and their clients."[27] The Chairman went on to mention issues with the proxy voting process regarding inadequate transparency, conflicts of interest, limited to no issuer engagement and the potential need for change in regulation.

Spectrem Group, in collaboration with industry expert J.W. Verret, wanted to understand how retail investors view proxy advisory firms and the potential increased oversight of that industry. Spectrem wanted to test the level of knowledge of retail investors regarding proxy advisors and their level of concern and support for potential areas of increased oversight or regulation by the SEC.

In addition to setting a baseline of sentiment, Spectrem also felt it was critical to determine how information, a critical component of our capital market system, impacted retail investor sentiment of proxy advisors – specifically, if retail investors unaware of proxy advisory issues would change their level of support for SEC oversight as they became more knowledgeable. The data from this survey of retail investors should provide tremendous insight to help inform the direction and prioritization of potential regulatory changes.

Section I: The Importance and Support of Proxy Advisor Oversight

Retail Investor Voter Participation and Interest

Do retail investors care about voting their proxies? Yes; 84 percent of retail investors indicated that having a choice in how their shares are voted was at least slightly important. When looking at investors who consider themselves to be well informed on the subject of proxy voting, proxy advisors and the proxy process, that percentage jumps to 97 percent.

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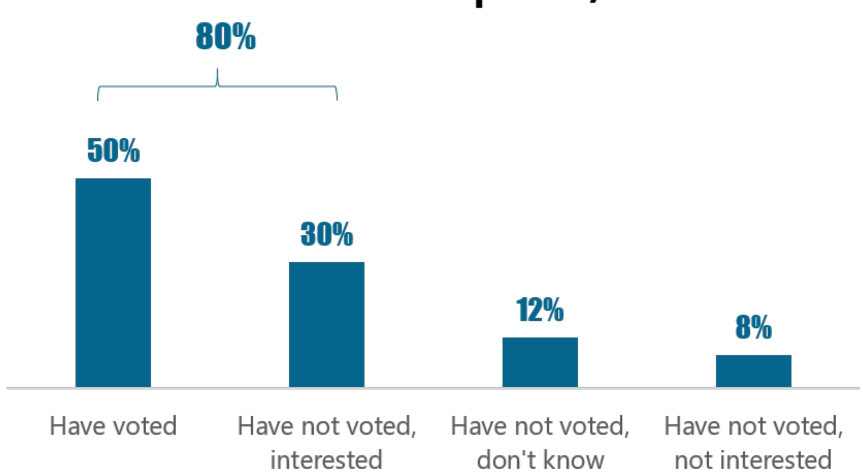
[27] Chairman Jay Clayton, Statement Announcing SEC Staff Roundtable on the Proxy Process, July 30, 2018, available at https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process

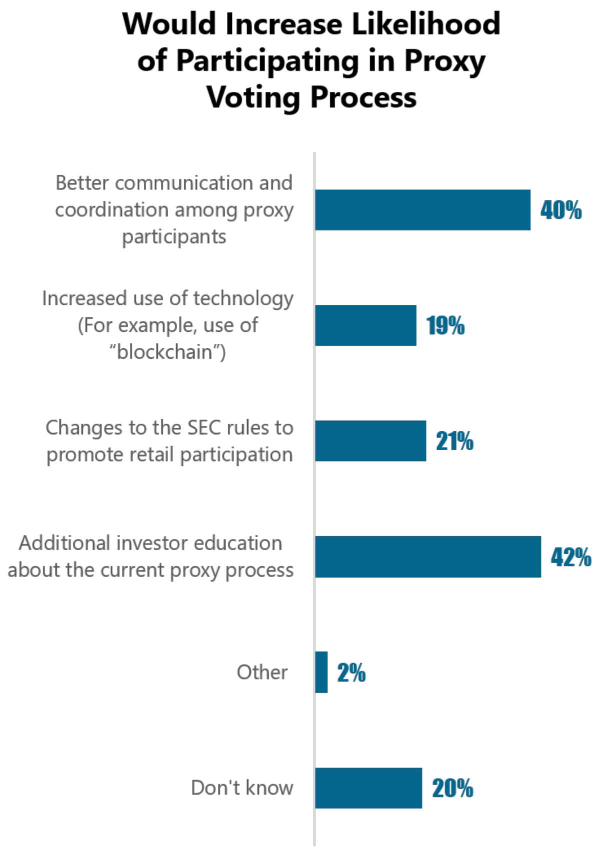
Feel it is Very/Moderately/Slightly Important to Have a Choice in How Shares are Voted

Half of respondents (50 percent) have voted shares via proxy previously. Among those who have not, it is important to understand whether their lack of involvement is from low interest or other reasons. Spectrem inquired as to the level of interest in voting at future meetings, among those who have not voted shares before, and more than two-thirds (68 percent) of investors indicated they would be interested in voting in the future. It's worth pointing out that of the entire survey sample, 80 percent of retail investors have voted shares in the past or are interested in voting in the future; 12 percent don't know if they're interested; and only 8 percent have not voted and are not interested in voting in the future.

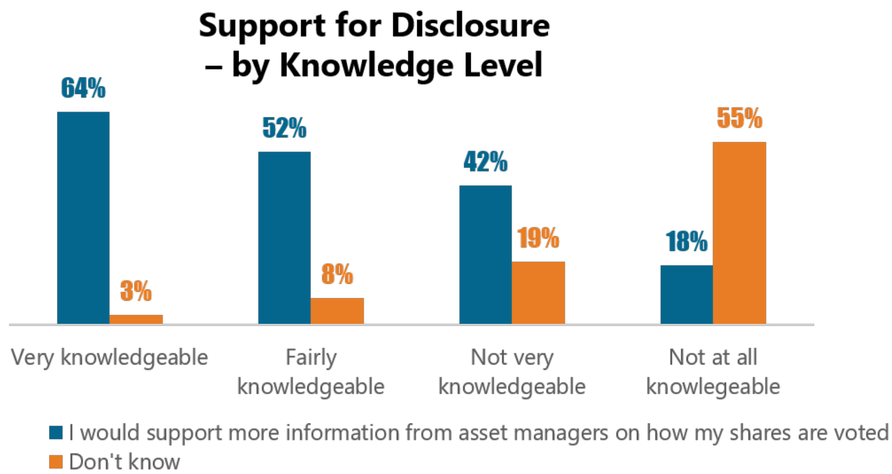
Retail Voter Participation/Interest



How exactly can the financial industry increase retail investor proxy voting participation? What would provide the greatest likelihood of increased participation? From the results, there appear to be two primary tools for increasing retail voter participation – better communication and additional education. As previously indicated, awareness is a critical component for retail investors, and 42 percent indicated that additional education would increase their likelihood of participating in the proxy voting process. Nearly an equal amount (40 percent) indicated that better communication and coordination would make them more apt to participate in the future.

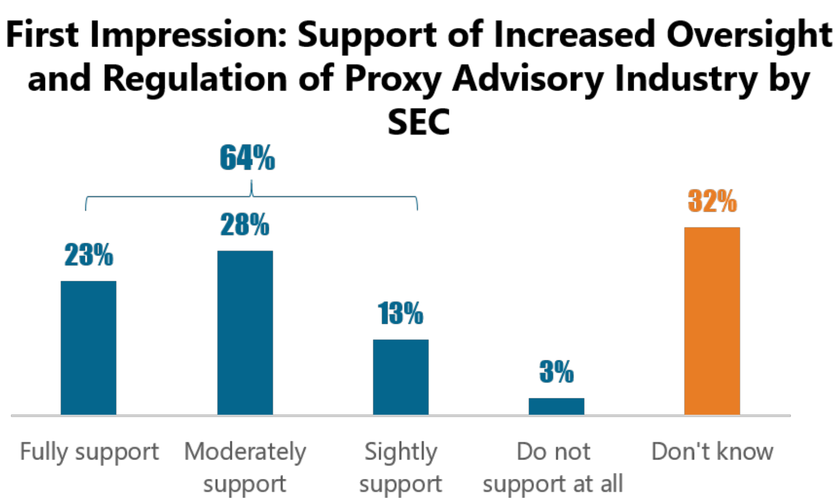


Even if they are not directly making voting decisions, 49 percent of investors support receiving more information about how asset managers vote their shares. Ironically, support for additional vote disclosure was particularly high for investors who identified as "very knowledgeable" about proxy advisors – and low for those who were not. This may imply a high threshold of education required for non-financially savvy retail investors.

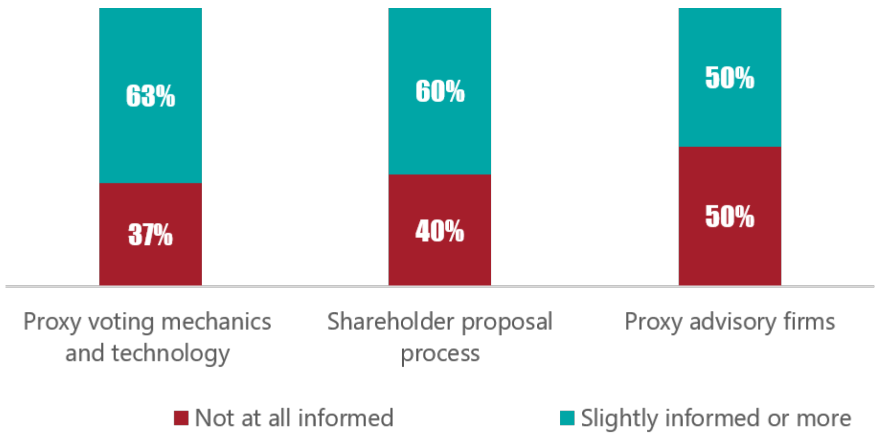


Retail Investor Support of SEC Oversight of Proxy Advisors

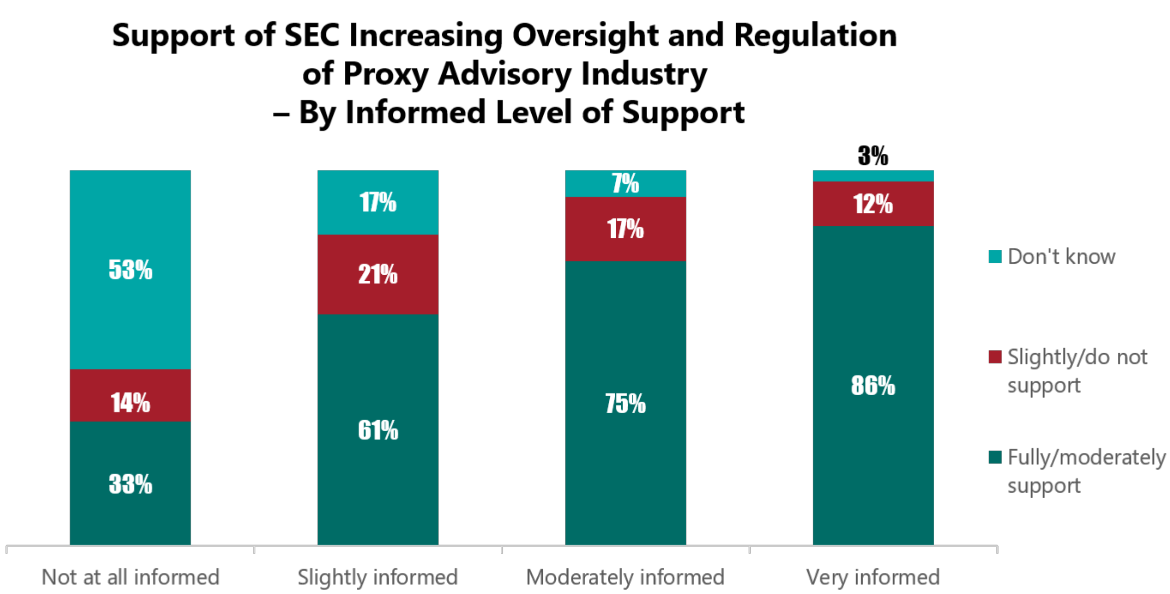
Determining a baseline level of retail investor support was a key first step to measuring sentiment. To begin the survey, Spectrem asked investors to rate their overall support increased SEC oversight and regulation of the proxy advisory industry. Almost two out of three (64 percent) retail investors at least slightly supported SEC action to increase oversight but, as expected, awareness played a large role in initial testing with nearly the entire other third (32 percent) of retail investors unsure if they would support the issue. Detractors were few and far between, with only 3 percent of retail investors noting that they would not support increased oversight at all, and with 51 percent of investors expressing moderate to strong support.



Perhaps one of the biggest challenges for the SEC is increasing awareness about proxy advisors. Of the issues discussed at the SEC roundtable (proxy voting mechanics, shareholder proposals and proxy advisory firms), retail investors are the least informed on the proxy advisory industry. In fact, 50 percent of investors noted they were not at all informed about the proxy advisory industry.

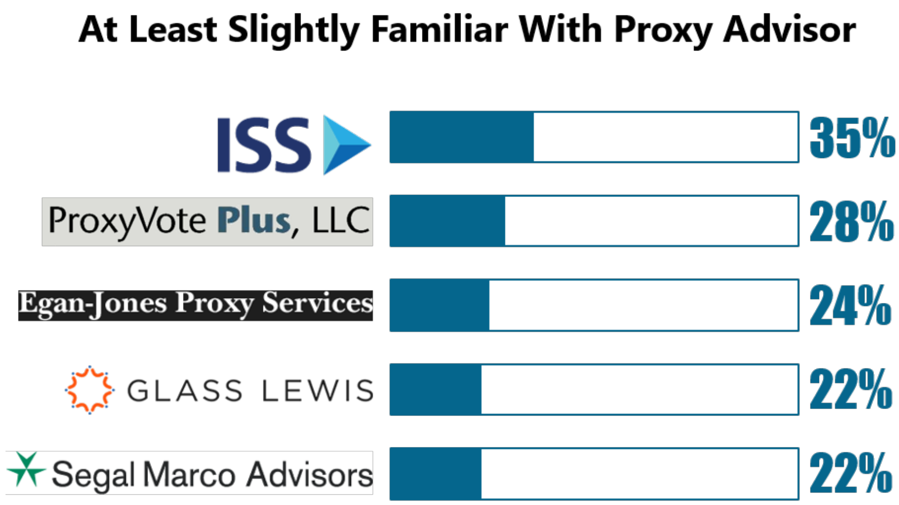


But how do informed investors view the topic? Ninety-eight percent of investors who consider themselves well informed regarding proxy advisors at least slightly support the increase of SEC oversight of the proxy advisory industry. Those informed, who constitute 20 percent of the overall sample, were more familiar, concerned and supportive of all surveyed SEC issues. This indicates that those informed about proxy advisors have stronger support for potential SEC action.



ISS Dominates Retail Investor Concerns

In addition to low industry awareness, retail investors also have limited knowledge of individual proxy advisory firms. Only 35 percent and 22 percent of investors have some familiarity of ISS and Glass Lewis, respectively, despite being the largest proxy firms in terms of market share.



One longstanding issue regarding the proxy industry is the concern of a duopoly. In a hearing on June 5, 2013, SEC Chairman Garrett stated that, "Two firms in particular you all know—[ISS], and [Glass Lewis]—account for around 97 percent of the proxy advisory industry."[28] When informed that the two largest advisors control 97 percent of the market, retail investors became concerned about the potential negative impact on capital markets. In fact, three out of four (76 percent) investors indicated at least slight concern regarding the duopoly, with half (50 percent) indicating they were moderately to very concerned about this issue.

[28] Examining the Market Power and Impact of Proxy Advisory Firms Hearing Transcript, page 2

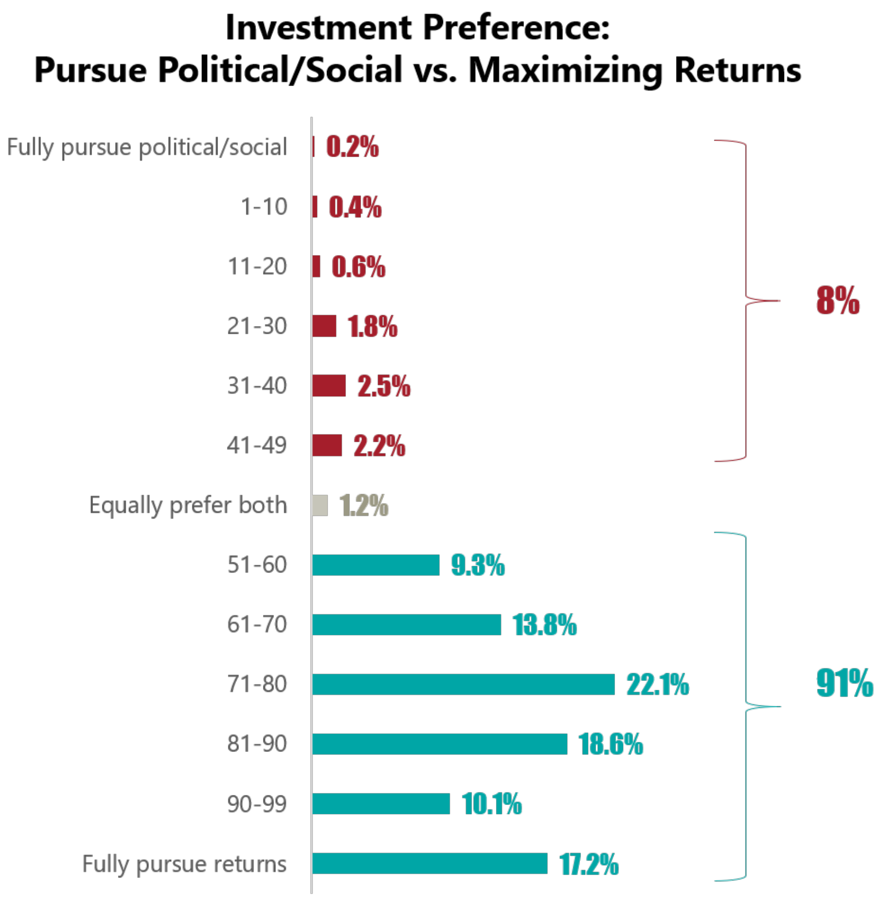
Concerned That a Duopoly in Market is Negatively Impacting Capital Markets

Investors Focus: Maximizing Returns

Rooted in the discussion of proxy advisors is the debate surrounding shareholder proposals. Trade groups have argued that proxy advisors' influence on political and socially aligned shareholder proposals do not serve in the best interests of retail investors.[29] That said, what are retail investor priorities?

When asked to decide between return-focused objectives and political/social objectives, 91 percent of investors demonstrated that they prefer maximizing returns over political/social objectives. In fact, 17 percent of the sample fully aligned with return maximization, whereas only 0.2 percent fully aligned with political/social objectives. Retail investors' average value in weighing these factors was 76 percent – indicating a more than 3-to-1 ratio of return to political/social respondents.

[29] https://www.manhattan-institute.org/html/proxy-advisory-firms-empirical-evidence-and-case-reform-11253.html



Section I: Summary

In summary, retail investors view proxy voting as important, and those who are informed largely support the SEC increasing oversight or regulation of proxy advisory firms. To increase retail investor participation, investors desire more communication and education. Currently, investors are concerned that a duopoly may be negatively impacting their financial returns, which is ultimately the chief objective above any political/social consideration. Next, we will look deeper at the issues plaguing the proxy advisory industry.

Section II: Largest Problems with Proxy Advisors

The survey addresses five issues that have been presented regarding the proxy advisor industry. They are:

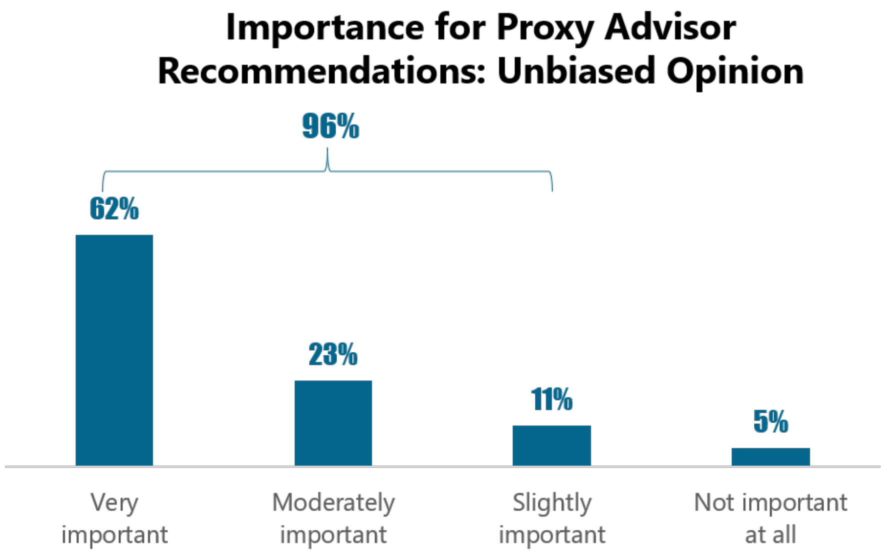
1. Conflicts of Interest
2. Robo-voting
3. Lack of Transparency
4. Errors in Reporting
5. Lack of Engagement with Issuers

Spectrem felt it was important to investigate the level of knowledge that retail investors had regarding these issues, their level of concern and ultimately how supportive they are about the SEC changing oversight or regulations to mitigate the issues. Because awareness of these issues ranged between 30 and 40 percent of investors, Spectrem included background context to clarify complex definitions or terms to investors.

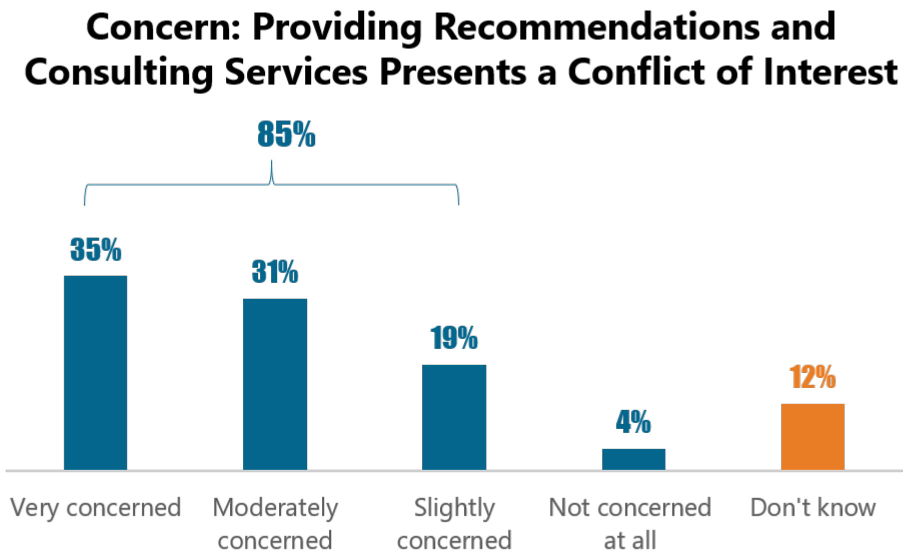
Conflicts of Interest

Conflict of interest is a key issue that has been raised with regard to proxy advisory firms. The premise of this issue is that proxy advisors have conflicts of interests in their business that undermine the objectivity of voting recommendations. Spectrem found that 45 percent of retail investors were at least slightly familiar with the potential conflicts of interests prior to the survey.

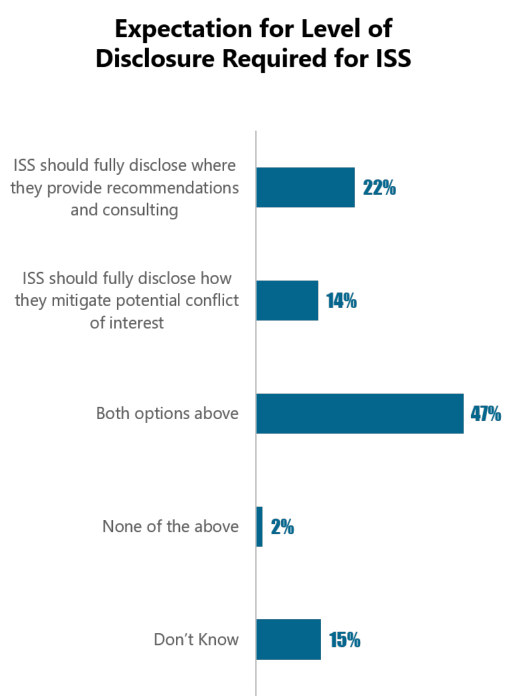
However, over 95 percent of retail investors stated that remaining unbiased is critically important, with 62 percent deeming it "very important."



One large conflict for proxy advisors lies with consulting services. ISS provides company recommendations and sells consulting services on how companies can improve their performance for those same recommendations. This dynamic creates a "quid-pro-quo" environment and may jeopardize the objectivity or appearance of advisor recommendations. When informed of this potential conflict, 85 percent of retail investors indicated they were at least slightly concerned, while 66 percent indicated they were moderately to very concerned.

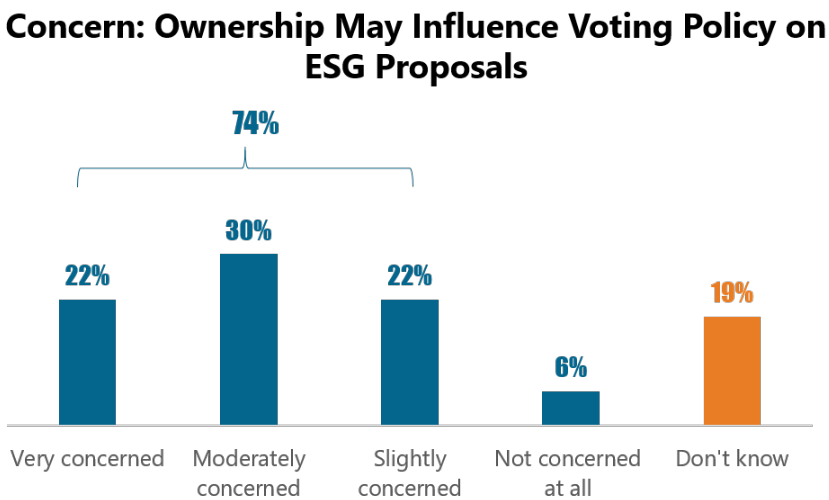


Considering the high concern surrounding the fact that ISS provides both research recommendations and consulting services, 85 percent of investors said that ISS should fully disclose the companies for which they provide recommendations and consulting services and/or fully disclose how they mitigate that potential conflict of interest. Only 2 percent of investors do not feel that either option is a valid expectation.

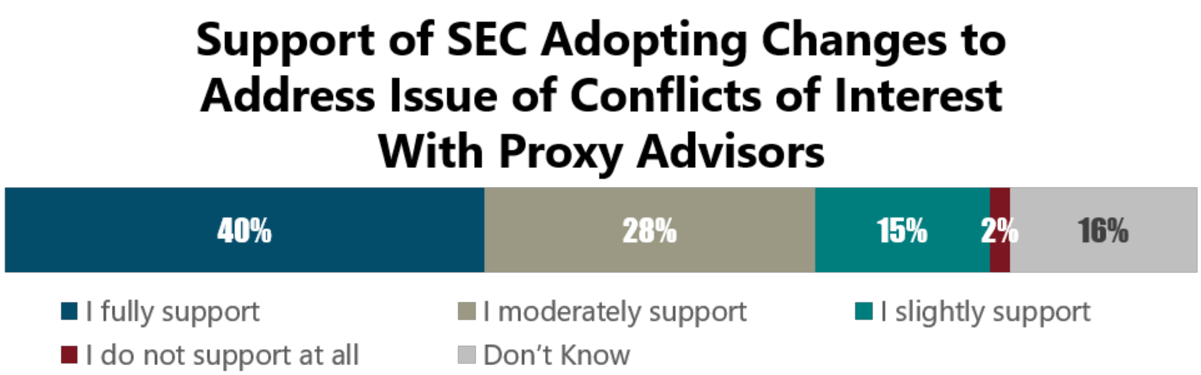


Glass Lewis does not provide consulting services but does potentially suffer from a different conflict of interest. Glass Lewis is co-owned by the asset manager Ontario

Teachers' Pension Plan Board. The fund actively supports and submits ESG shareholder proposals, and there is concern that Glass Lewis would be influenced by the ESG preferences of their owner group. Three quarters (74 percent) of investors are at least slightly concerned about this conflict, with 52 percent expressing they were moderately to very concerned. Only 6 percent of investors are not at all concerned about this potential issue.



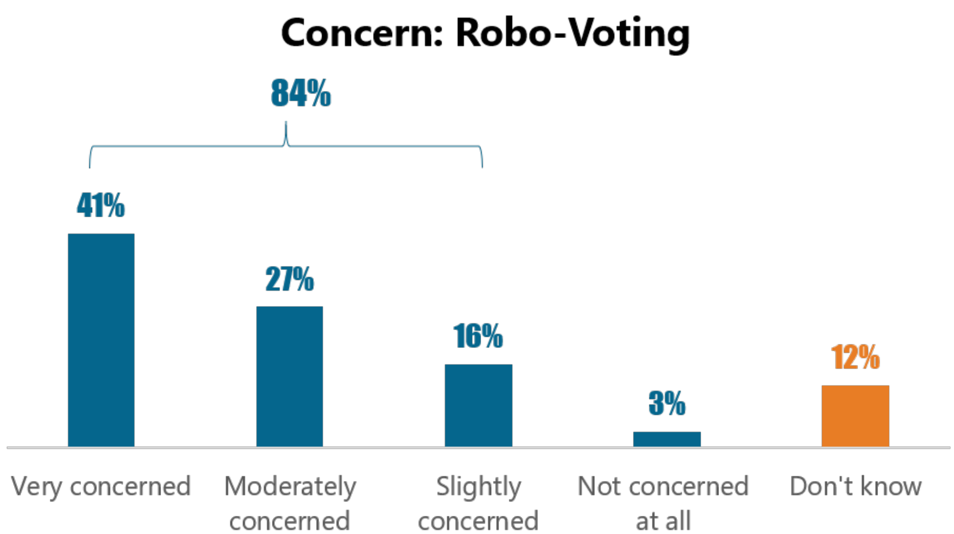
Only 2 percent of investors don't support SEC adoption of changes to address conflicts of interest; the data demonstrates overwhelming support (83 percent) from retail investors with regard to the SEC making changes to address this issue. In fact, 68 percent of investors are moderately or very concerned about conflicts of interest.



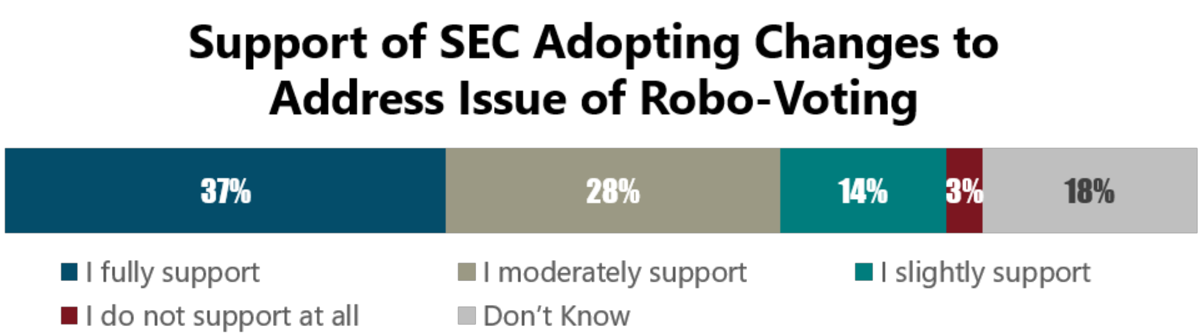
Robo-Voting

Another potential concern within the proxy advisor industry is robo-voting, or the practice of asset managers voting proxies automatically and without evaluation, relying completely on recommendations from proxy firms' recommendations. Robo-voting has the potential to breach an asset manager's fiduciary duty to their investors. While asset managers receive recommendations from proxy advisor firms, they still have a fiduciary duty to evaluate the issue themselves. Spectrem found that 40 percent of investors were familiar with robo-voting prior to the survey.

Of all tested issues, robo-voting was the most concerning to retail investors. Eighty-four percent of retail investors indicated at least slight concern regarding robo-voting, and 68 percent indicated they were moderately to very concerned. As previously noted, investor focus is squarely on return maximization, and any fiduciary breach may trigger increased concerns for retail investors. Only 3 percent of investors are not at all concerned about this potential issue.



Just 3 percent of investors don't support the SEC adopting changes to address robo-voting. Seventy-nine percent of investors at least slightly supportive of SEC changes to address this issue, and 65 percent of respondents said they moderately to fully support action by the SEC.

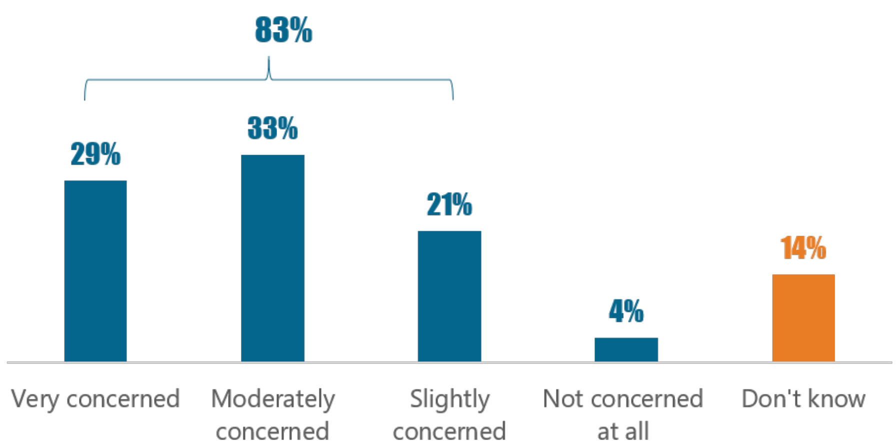


Inadequate Transparency

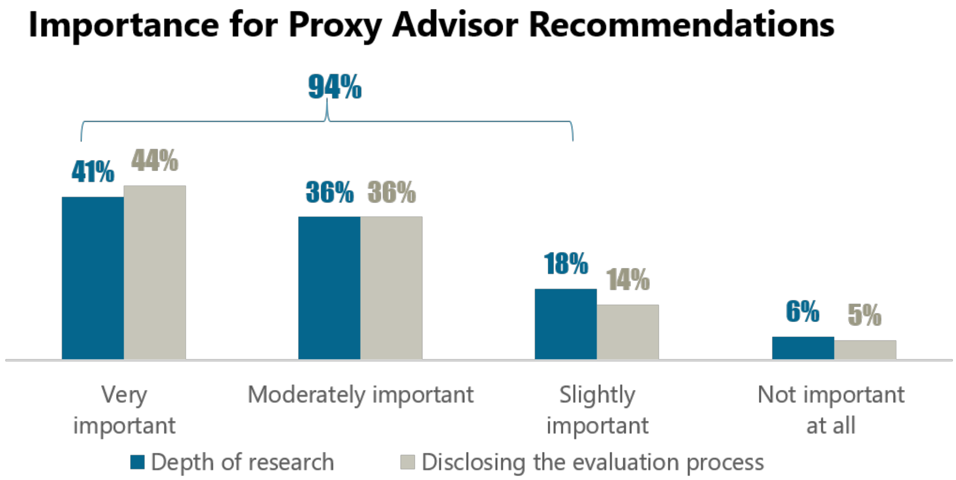
The proxy advisor evaluation process is one that is cloaked in mystery, not providing any transparency as to how the process is conducted. This lack of transparency makes it challenging for stakeholders to understand how voting recommendations are created and whether they are in the best interests of their clients. Also, without disclosing the process, there is concern that company-specific situations may not be considered when developing recommendations. Spectrem found that 45 percent of investors were familiar with transparency problems prior to the survey.

The policies and procedures used by proxy advisory firms to determine a voting recommendation are opaque, not clearly shared nor understood. Eighty-three percent of retail investors were at least slightly concerned and nearly two-thirds (62 percent) said they were moderately or very concerned about the issue. Only 3 percent of investors are not at all concerned about this potential issue.

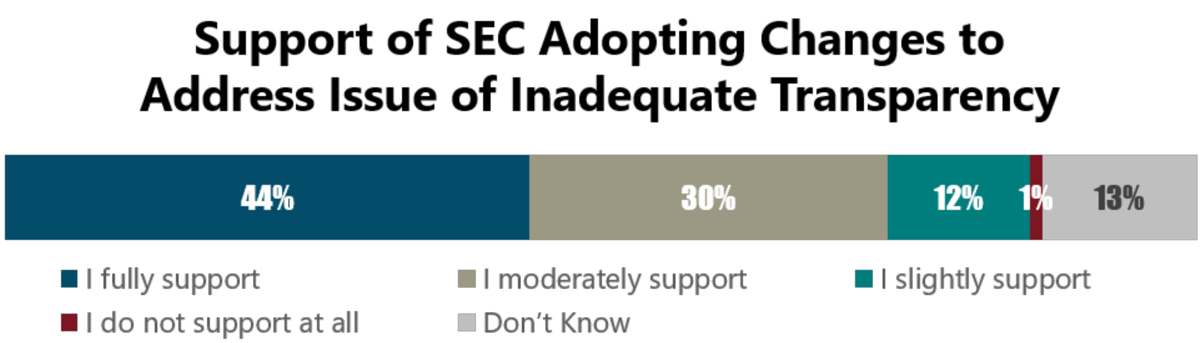
Concern: Proxy Advisors Lack Transparency in Their Recommendation Process



This high concern is not surprising considering the problems that arise from insufficient transparency. Jointly, 94 percent of retail investors indicated that both the depth of research and full disclosure of the process were at least slightly important to the recommendations that proxy advisors provide. Only 6 percent of investors said these elements were not important.



Only 1 percent of investors don't support the SEC adopting changes to address poor transparency. Given the concern and importance of this issue, it is unsurprising that transparency was the most supported issue for new SEC oversight. Seventy-four percent indicated moderate to full support, and 86 percent indicated at least some support. Retail investors would clearly like to see the SEC address one-size-fits-all approaches.



Errors in Proxy Advisor Reports

Proxy advisory firms are composed of human beings. Their reports are created by humans, which unfortunately can result in errors. A paper commissioned by the American Council for Capital Formation reviewed supplemental proxy filing during 2016, 2017 and part of 2018, during which there were 139 significant errors within 107 filings from 94 companies. Forty-nine of these errors were considered to be serious.[30] Spectrem found that 36 percent of investors were familiar with proxy advisor report errors prior to the survey.

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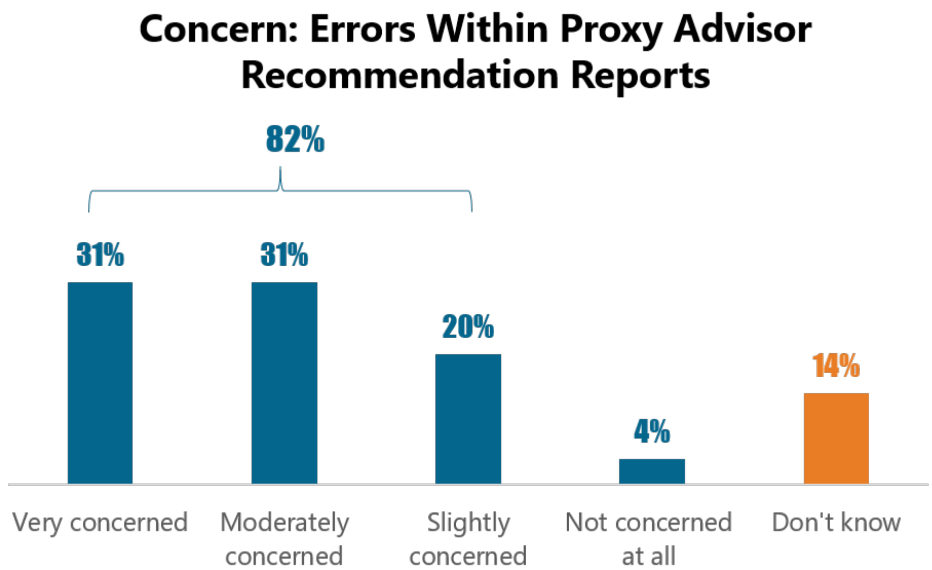
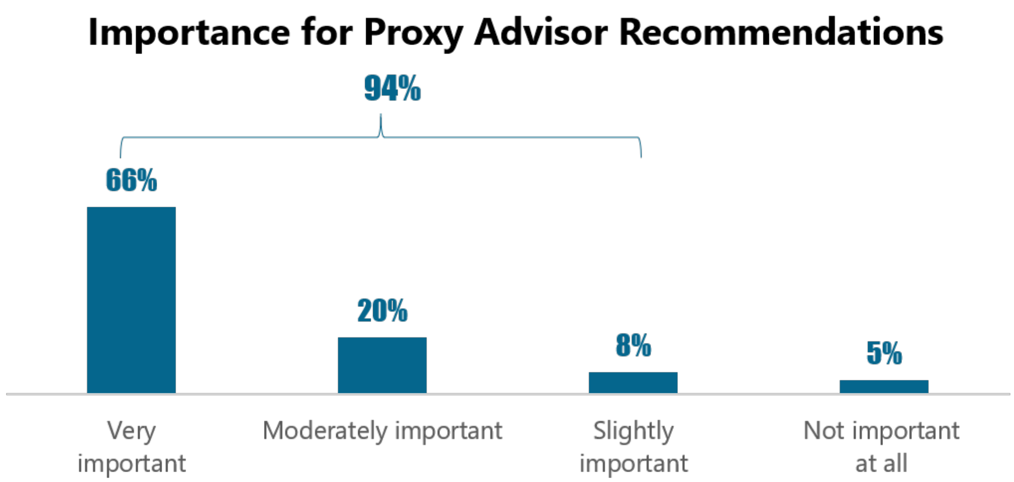
[30] Frank M Placenti, "Are Proxy Advisors Really a Problem?" (Squire Patton Boggs; commissioned by American
Council for Capital Formation)

Retail investors express significant concern regarding errors. Eighty-two percent of retail investors indicated at least slight concern regarding errors, and 62 percent indicated they were moderately to very concerned. Only 4 percent of investors are not concerned about this potential issue at all.

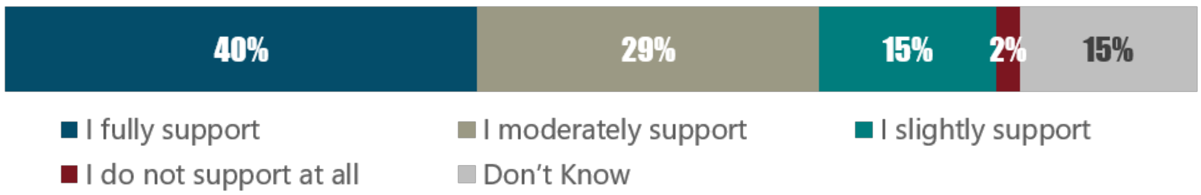


While overall concern about errors was relatively the lowest compared to other tested issues, importance of report accuracy scored the highest. In fact, 66 percent of respondents said that it was "very important" for proxy advisor reports to be accurate.



Only 2 percent of investors do not support the SEC addressing the issues of errors. More than two-thirds of investors (69 percent) moderately or fully support this change, while 15 percent aren't sure what to think about this topic.

Support of SEC Adopting Changes to Address Issue of Errors

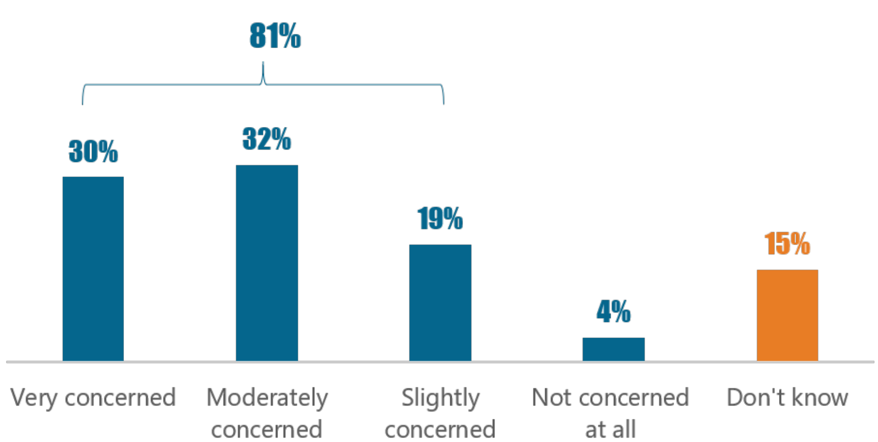


Refusal to Engage with Issuers

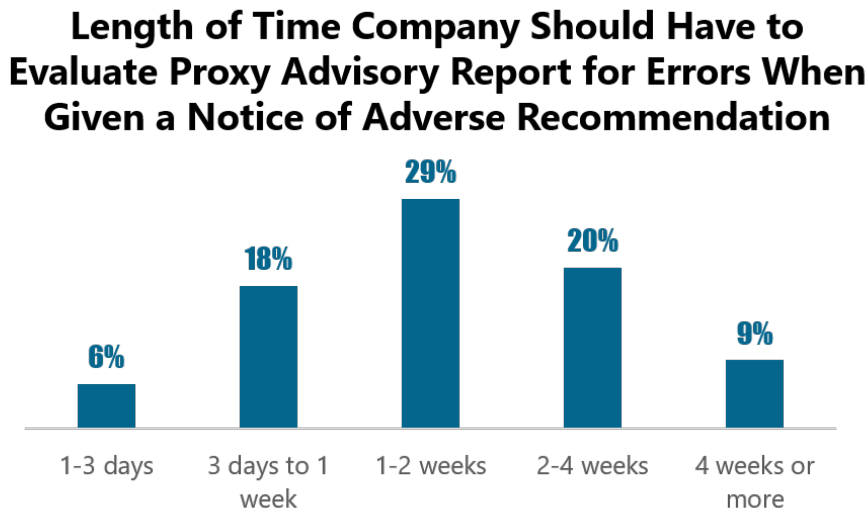
When proxy advisors disagree with a company, they release what is called an "adverse recommendation," wherein they recommend voting AGAINST management. When releasing an adverse recommendation, proxy advisors rarely provide the company with an opportunity to comment. In fact, a recent study of companies showed that Glass Lewis did not provide advanced notice in 84 percent of adverse recommendations. With no ability to ensure the accuracy of information, companies cannot respond to potential errors. Spectrem found that 36 percent of investors were familiar with proxy advisor report errors prior to the survey.

Investors are concerned about this lack of engagement with issuers. Eighty-one percent of retail investors indicated at least slight concern regarding engagement, and 62 percent indicated they were moderately to very concerned. As previously noted, because proxy advisor reports can contain errors, it is critical that they at least offer issuers the ability to review the accuracy of their reports. Only 4 percent of investors are not at all concerned about this potential issue.

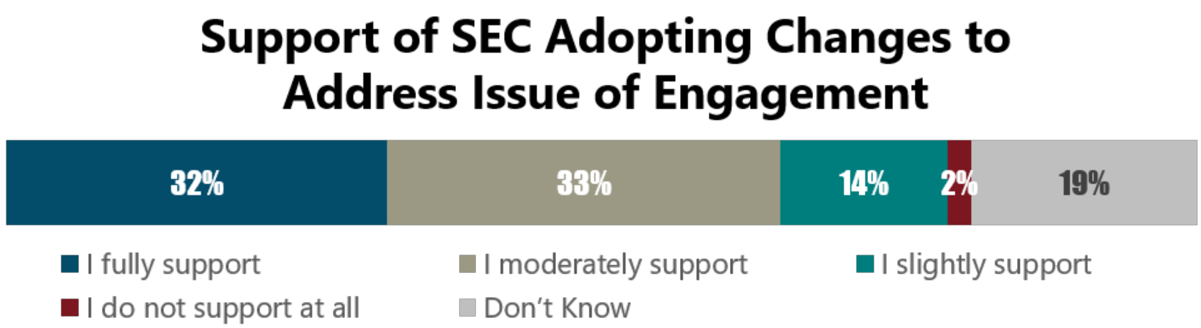
Concern: Refusal to Engage Issuers



Seeking not only awareness and level of concern of an issue, but how to solve it is something that Spectrem attempted to solve throughout the study. In the case of adverse recommendations, Spectrem asked about the time frame a company should be given to evaluate a report from a proxy advisor for errors, and to interact with the firm to correct those issues. Over one quarter (29 percent) of investors feel that issuers should have one to two weeks to evaluate an adverse recommendation, while another 20 percent feel that issuers should have two to four weeks.

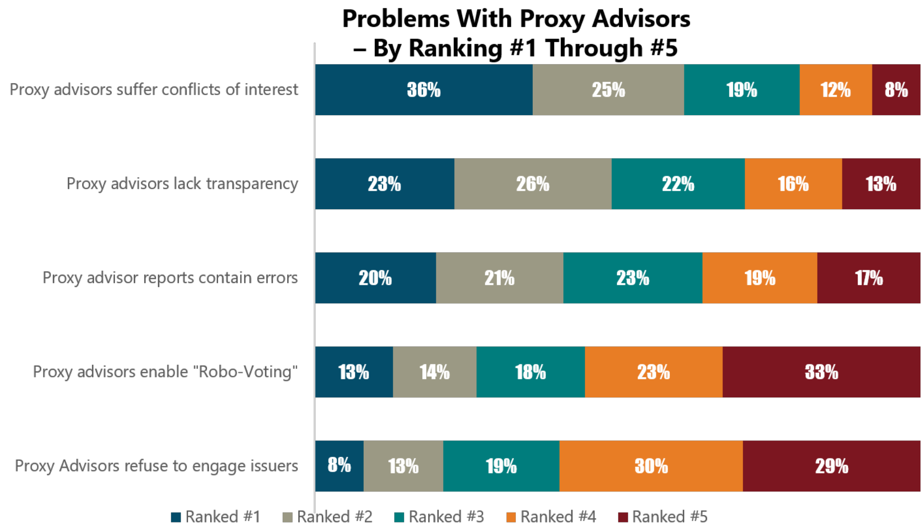


Nearly two-thirds (65 percent) of retail investors moderately or fully support the SEC enacting changes to address the issue of engagement – and 81 percent at least slightly support the issue.



Section II: Summary

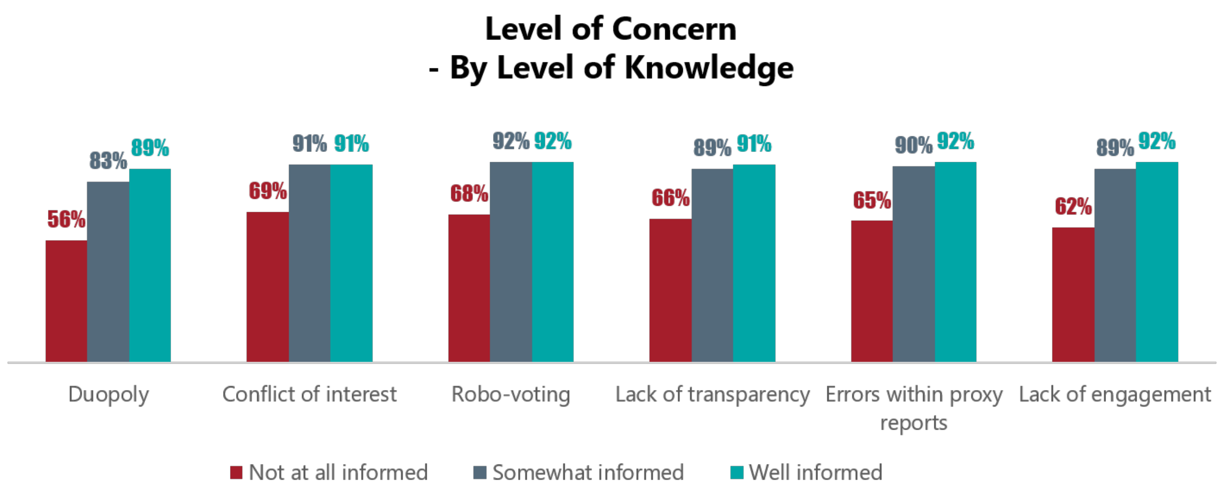
More than two-thirds of investors are concerned about all five issues Spectrem examined in this study. To determine which issue is of greatest importance to investors, we asked investors to prioritize potential SEC actions. Thirty-six percent of investors said that conflicts of interest should be the first issue addressed, followed by 23 percent who feel that a lack of transparency is the most important issue.



While the highest level of concern among investors regards conflicts of interest, the proxy advisor issue investors would support changes proposed to the SEC is in the area of transparency. The failure of proxy advisors engaging with users is the lowest rated concern among the five issues discussed.

Section III: The Impact of Information

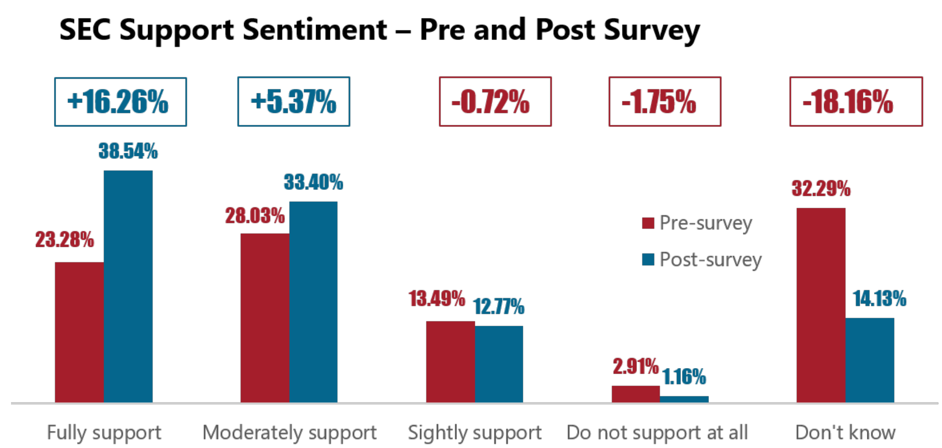
Retail investors' level of knowledge regarding the various issues in the proxy advisor industry creates a distinct gap in level of concern. As each issue illustrates, with increased knowledge comes increased concern. Well-informed investors have an average 26-percent higher level of concern when compared to those who are not informed.



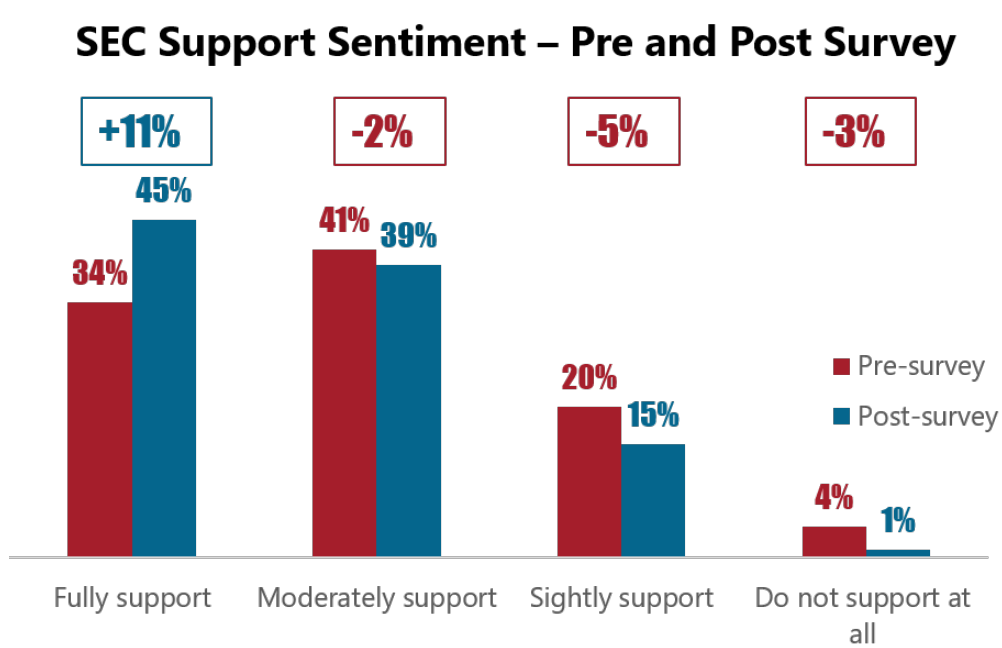
Re-Testing Support for SEC Oversight

At both the beginning and end of the survey, Spectrem tested overall support levels held by retail investors for SEC oversight. The change in support level may be used to gauge how exposure to industry issues and learning about the proxy advisor process may impact retail investor opinion and preferences. By all metrics, investor appetite for increased SEC oversight dramatically increased.

First, let's look from an absolute basis, where investors who previously didn't have a vantage point expressed their support for SEC oversight. Pre-survey, 32 percent of investors did not have a point of view; post-survey, only 14 percent remained uncertain. These investors largely shifted from completely unaware to fully supportive (increase of 16 percent).



Further, it's statistically important to view the relative change in support from those who expressed a view at the onset. Removing "don't knows" from the analysis also shows that 11 percent more investors now "fully support" oversight, an increase from 34 to 45 percent.



As a result of the survey, Spectrem noticed a majority of investors (56 percent) changed their overall level of support. After being informed of the various potential issues in the proxy advisor industry, of those who changed their views, *76 percent of retail investors increased their level of support for SEC oversight of proxy advisors.*

Recommendations - by J.W. Verret

1. Conflicts of Interest at Proxy Advisors

In determining what regulatory steps to take, it's worthwhile to reiterate *"those who have put or are putting $50, $100, $200 a month away for years and years"* are the most critical audience of consideration. This survey provides a rich resource for the SEC by soliciting views on the issue of proxy advisors directly from retail investors.

If ISS and Glass Lewis were conflict free, offered robust recommendations based on increasing shareholder value and did not obtain demand for their services in part through regulatory pressure, then there would be little reason for the Commission to take action on these issues. Unfortunately, that is not the case.

Conflicts of interest at the two dominant firms in the proxy advisory industry manifest themselves in two primary ways. The first and more subtle conflict is the influence of proxy advisors' clients on the recommendations issued. Substantial income is provided by "socially responsible" investing funds to proxy advisors, which are in turn incentivized to favor proposals that are backed by these clients. When retail investors were apprised of this problem, they strongly demanded responsive action from the Commission.

These conflicts of interest are exacerbated by the level of market power the top two firms enjoy. Retail investors expressed concern about this as well. Twenty-nine percent of participants expressed some familiarity with the dominant proxy advisory firm, ISS. Fifteen percent expressed some familiarity with the second-largest proxy advisor, Glass Lewis. When told that some are concerned that ISS and Glass Lewis represent a duopoly in the market, limiting new competitor entrants, an overwhelming 76 percent of respondents expressed some level of concern.

While it would not be appropriate for the SEC to directly regulate the market share of proxy advisory firms, this research does suggest retail investors would welcome Commission attention to rules that may entrench the dominant position of these firms, in addition to devoting attention to conflicted advisory fees that further cement the dominant position of ISS in the market.

The current dynamic for proxy advisors deviates from a focus on shareholder value, generating private benefits to a subset of investors at the expense of the average diversified investor. This has implications for another of the roundtable's areas of focus: the role of shareholder proposals in the proxy process. In effect, proxy advisors have been granted the ability to wield the aggregate influence of their clients to the benefit of a particular type of investor – potentially at the expense of the interests and expectations of retail investors.

The second and more obvious conflict that exists in the proxy advisory industry is the provision of consulting services to the same issuers about which recommendations are issued to investors. The implicit threat of receiving a negative recommendation from ISS is a cornerstone of the offering from that same company to publicly listed companies.

There are analogous concerns over conflicts of interest in other areas of financial services, particularly those stemming from the provision of consulting services. The investment community itself (including the Council for Institutional Investors and California Public Employees' Retirement System) has been steadfast in arguing against the provision of consulting services by a company's external auditor. Simply disclosing and "mitigating" the existence of a material conflict would not be seen as acceptable to auditors or credit rating agencies; it is unclear as to why it is sufficient for the proxy advisor industry. A proxy advisor simultaneously providing governance advisory services and recommendations is akin to an auditor providing an issuer with guidance on how to navigate an external audit.

The retail investor survey shows that retail investors do not take the same "see no evil, hear no evil" approach to conflicts of interest at proxy advisory firms, but instead quickly see the case for addressing conflicts of interest at proxy advisors and would welcome Commission action to address this issue. While additional disclosure about conflicts of interest may prove helpful, the substantial market power given to ISS through prior Commission action suggests prohibition may be warranted for conflicted consulting provision by proxy advisors.

The concerns of retail investors are compounded by their relative lack of involvement in the proxy process. Only 50 percent of respondents, 2,567, had ever voted their shares, though 68 percent expressed some level of interest in voting their shares in future meetings. Forty-nine percent responded that they wanted more information from asset managers on how shares are voted; only 33 percent suggested current vote disclosure by asset managers was sufficient.

This result is consistent with the notion that retail shareholders don't tend to see active voting as beneficial. At the same time, when made aware of the potential that shares may be voted on their behalf in ways that conflict with their interest by asset managers, retail investors would prefer additional disclosure.

2. *Proxy Advisor Disclosure*

The objective of corporate governance is the enhancement and protection of shareholder value; however, it remains unclear what role shareholder value plays in the processes and methodologies of proxy advisors. In fact, the evidence appears to point to the contrary, as a lack of capacity and capability, conflicts of interest and ideological bias result in proxy advisor recommendations by ISS and Glass Lewis depleting shareholder value.

The retail investor survey shows that the social and political focus of many proxy advisory firms is inconsistent with the shareholder return focus of most retail investors. Further, many investors are eager for disclosure about how these conflicts of interest may be impacting their portfolios.

In two separate Stanford University studies,[31] researchers found that the recommendations of ISS negatively impacted shareholder value, with investors better off ignoring ISS. ISS also promulgates other corporate governance policies for which the empirical evidence is mixed, at best, including the right to nominate director candidates to the corporate proxy,[32] options repricing,[33] independent chairs[34] and Golden Parachutes.[35] While these policies are certainly favored by politically minded institutional investors – ISS's largest clients – they are not clearly linked to the enhancement of shareholder value and thus stronger returns to the ultimate beneficiaries of mutual funds.

In many ways, it would be unreasonable to expect the two dominant proxy advisors to be effective in providing accurate and nuanced corporate governance advice to investors. ISS's website states that it covers over 42,000 meetings a year for a client base in excess of 1,700, while Glass Lewis produces analysis on more than 20,000 companies. The combination of minimal resources and significant influence is cause for concern and should provide an impetus for greater SEC oversight in order to protect investors.

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[31] David F. Larcker, Allan L. McCall, and Gaizka Ormazabal, "The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policy" (Rock Center for Corporate Governance at Stanford University Working Paper No. 119, Stanford, CA, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id= 2101453. David Larcker, "Do ISS Voting Recommendations Create Shareholder Value?" (Rock Center for Corporate Governance at Stanford University, Closer Look Series: Topics, Issues and Controversies in Corporate Governance and Leadership No. CGRP-13, Stanford, CA, April 19, 2011): 2, http://papers.ssrn .com/sol3/papers.cfm?abstract_id=1816543##.

[32] See Thomas Stratmann and J.W. Verret, "Does Shareholder Proxy Access Damage Share Value in Small Publicly Traded Companies?," Stanford Law Review 64 (2011): 1431–68.

[33] The debate over whether options repricing is material to executive compensation packages is explored in Brian J. Hall and Thomas A. Knox, "Underwater Options and the Dynamics of Executive Pay-to-Performance Sensitivities," Journal of Accounting Research 42, no. 2 (May 2004): 365–412.

[34] See generally Roberta Romano, Foundations of Corporate Law, 2nd ed. (New York: Thomson Reuters/Foundation Press, 2010) 410–25

[35] See generally Richard A. Lambert and David F. Larcker, "Golden Parachutes, Executive Decision Making and Shareholder Wealth," Journal of Accounting and Economics 7 (1985).

By policy, Glass Lewis does not provide issuers with any opportunity to review recommendations, while ISS limits the opportunity to only the largest companies in the United States. Eighty-one percent of survey respondents expressed some level of concern when presented with a study suggesting that major proxy advisors did not provide issuers with an opportunity to comment on adverse proxy recommendations in 84 percent of cases.
This concern from retail shareholders is unsurprising – ISS itself accepts that the review process is of benefit to multiple stakeholders:

> "ISS believes that this review process helps improve the accuracy and quality of its analyses, an outcome that is in the best interests of both the institutional investors for whom the analyses are prepared, as well as for the companies that are the subject of these reports."[36]

BlackRock, the world's largest asset manager, also expressed a preference for the SEC to explore technology solutions such as a digital portal for the review of draft company reports, which would provide companies with at least two business days to correct errors prior to the report's publication to shareholders and allow companies to submit a rebuttal to be included in the final report.[37]

When asked how much time issuers should be granted to review proxy advisor recommendations and remedy potential errors, the largest share of respondents (29 percent) suggested an appropriate time period to be between one and two weeks. Seventy-nine percent of respondents expressed some level of support for the SEC addressing the concern that proxy advisors fail to engage with issuers.

With over half of U.S. annual general meetings taking place in a three-month period, both advisors must, by necessity, put in place rigid methodologies in order to produce the volume of reports they do. The problem with rigid methodologies is that they simplify the complexities of business reality and do not allow for case-by-case appraisals of company practices and disclosure.

The inability of the two dominant proxy advisors to offer company- and circumstance-specific recommendations, and the limited empirical evidence supporting those recommendations, calls into question whether ERISA and mutual fund fiduciaries are fulfilling their obligations in relying on the proxy advisor advice of ISS and Glass Lewis.

Eighty-four percent of respondents stated they were concerned with the practice of robo-voting, with only 3 percent of investors failing to indicate support for the SEC to address this issue. Eighty-six percent of respondents supported SEC action to improve transparency in proxy advisors, and 83 percent of respondents offered

[36] https://www.issgovernance.com/iss-draft-review-process-u-s-issuers/
[37] https://www.sec.gov/comments/4-725/4725-4656351-176506.pdf (November 16, 2018)

some level of support for Commission action to address the problem of errors in proxy advisor recommendations.

Disclosure can only help shine the light on what proxy advisors are actually delivering. Retail investors may have the right idea. Fewer votes on wasteful ballot issues may be the right approach, in which case intermediary institutions will have less need for proxy advisors. This is particularly true when the dominant players in this industry are motivated by conflicts that run counter to the interests and expectations of most retail investors – the ultimate beneficiaries for whom the SEC wants to improve the proxy process.

3. *Clarification of Fund Fiduciary Duties with Respect to Share Voting*

While there are times when active share voting can generate value for investors, it remains unclear whether that is always the case system-wide. Institutional investors should be able to establish a default voting process that votes with management, absent a clear red flag suggesting further inquiry is necessary. Based on the SEC's current guidance, it is not clear that institutional investors could establish such a policy. The SEC could remedy that problem with a change in its mutual fund voting guidance.

The Commission observed in its original release that "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." While it would appear the Commission is indicating it does not require active voting by mutual funds, in fact the adopting release taken as a whole suggests a presumption in favor of active voting management, with the burden on funds to show that active voting is not beneficial.

A large percentage of shareholder proposals, on which proxy advisors provide recommendations, are defeated. Indeed, in 2017, only 5 percent of all shareholder proposals received a majority vote of support; 95 percent of them were rejected.[38]

The SEC should elaborate on language in its original adopting release to swap the presumption in favor of active voting by management to instead permit fund managers to refrain from voting – unless it is clearly demonstrated that the benefits of actively voting exceed costs. It should instead explicitly permit funds to adopt voting policies that reflect the lack of value in many voting contests. Asset managers should be able to adopt policies that eschew voting in general in instances of shareholder proposals, or adopt policies tailored to vote with management unless red flags listed by the fund's management are triggered (such as a recent restatement).

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[38] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.

An externality of the SEC's interpretation is the prevalence of robo-voting, an issue cited by retail investors as the most concerning. By appearing to remove the ability of institutional investors to adopt policies that allow for defaulting their vote in favor of management, regulatory guidance has channeled the collective influence of those same investors into the hands of two proxy advisors – neither of which owns a single share in a public company nor has a fiduciary obligation to any retail investor. In practice, through robo-voting, investors can default voting to proxy advisors but not to management.

The Commission should also make clear that if fund managers adopt voting policies intended to further political or social causes important to the fund's managers or controlling shareholder – which have not been shown to enhance shareholder value – those fund managers may violate their fiduciary duties to the fund's beneficiaries.

These conflicts could be manifested in many ways, including informal pressure during board elections or merger approvals. The most direct way they appear is via shareholder proposals, most of which are fairly characterized as displays of personal, political or social policy preferences with little relationship to shareholder value. Proxy Monitor observes that "proposals related to social or policy concerns with a limited relationship to share value constituted 56 percent of all shareholder proposals in 2017."[39] Given that institutional shareholders and the proxy advisors they employ should vote their shares in line with the interests of their clients and retail investors, the onus to clearly articulate a link between any proposal and shareholder value should set a high bar. Proxy Monitor tracks that from 2006 through 2015, companies received 1,347 shareholder proposals related to social or political matters. None of those proposals received a majority of shareholder support,[40] yet they place a cost on companies and other shareholders.

Conclusion

The findings of the retail investor survey show a wide gulf between the expectations of the retail investor community and institutional investors and proxy advisors who purport to act on their behalf. Conflicts abound in the proxy advisor industry that exacerbate that gulf, while a lack of transparency in the operation of proxy advisors strips retail investors of the ability to determine whether proxy votes are being registered with the sole goal of maximizing shareholder returns. The SEC's work in this area can help to address that gap. The survey provides a rare opportunity to hear directly from the ultimate stakeholders on proxy voting at a timely moment. It offers powerful evidence to inform future SEC action on proxy process reform, particularly with respect to issues posed to the functioning of the proxy process by conflicted, under-resourced and influential proxy advisors.

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[39] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.

[40] See James R. Copland and Margaret M. O'Keefe, Proxy Monitor 2017: Season Review, at http://www.proxymonitor.org/Forms/pmr_15.aspx.