First Affirmative
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Investing for a Sustainable Future

January 24, 2020

Vanessa A. Countryman, Secretary.
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
VIA email: rule-comments@sec.gov <rule-comments@sec.gov

RE: **File Number** S7-23-19

Dear Ms. Countryman,

We appreciate the opportunity to comment on the proposed rule, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8. First Affirmative Financial Network, LLC (First Affirmative) is an SEC registered investment advisor with oversight of more than $1 billion in assets under management and advisement. We serve a diverse, nationwide clientele who select our firm because of our deep expertise in the integration of environmental, social, and governance criteria when constructing client portfolios.

We are concerned that provisions in this proposed rulemaking would have a substantial adverse impact on our client's shareholder rights and unduly limit our ability to provide legitimate services that our clients expect from us. These clients easily fit the long-term Main Street investor description that Chairman Clayton alluded to in his remarks when the proposed rulemaking was released — veterans, teachers, public servants, single moms, retirees.

The proposed rulemaking has been described as being designed to protect these Main Street investors. Regrettably, our evaluation leads us to the conclusion that these investors, including our clients, will be less protected, with their rights significantly diminished, should these proposals be implemented in full.

First Affirmative serves a wide range of clients, from small individual investors saving for life goals such as college and retirement, to much larger individual investors, foundations and limited liability companies. Regardless of size, our clients expect and deserve a fully diversified portfolio designed to control risk and accomplish long-term financial goals, as well as active engagement with portfolio companies on material issues that impact long-term value.

We direct your attention to our previously submitted comments[1] in reference to file number 4-725, SEC Staff Roundtable on the Proxy Process, as the contents of the submission still accurately reflect our general concerns with regard to proposed rulemaking efforts within the context of our

[1] https://www.sec.gov/comments/4-725/4725-6377203-197303.pdf

client base and services. We also concur with the comments[2] submitted on by the Shareholder Rights Group, of which we are a member.

We offer the following additional comments to highlight the adverse impacts of these proposed rules on our clients and our investment advisory firm, not the least of which are the unexpected implications presented by a short footnote.

Footnote 70 — limiting the individual's right to designate a representative

A proposed amendment under *C. The Role of the Shareholder-Proposal Process in Shareholder Engagement* requires:

> "a statement from each shareholder-proponent that he or she is able to meet with the company in person or via teleconference. The shareholder would be required to include contact information as well as business days and specific times that he or she is available to discuss the proposal with the company."

This section is accompanied by footnote 70, which substantively changes the context and intent of this proposal. It states:

> "The contact information and availability would have to be the shareholder's, and not that of the shareholder's representative (if the shareholder uses a representative). A shareholder's representative could, however, participate in any discussions between the company and the shareholder."

This clarifying footnote would result in undue interference with the client/advisor relationship. Our clients currently authorize us to act on their behalf for many investment related activities, including making buy and sell decisions, voting proxies, and conducting shareholder engagement, to include filing shareholder resolutions. With regard to shareholder engagement, our clients specifically grant us this authority through an agent appointment that includes:

- The submission, negotiation and withdrawal of a specific shareholder proposal, including statements in support of such shareholder proposal.
- Requesting letters of verification from custodians to prove client eligibility
- Issuing a Letter of Intent to the company of client intent to hold securities required for eligibility to submit the shareholder proposal through the meeting date for such shareholder proposal.
- Attending, speaking, and presenting the proposal shareholder proposal at the shareholder meeting.

Footnote 70 implies that one specific aspect of this appointment is to be deemed invalid –dialogue with the company with regard to the issues brought up in the shareholder proposal. Our clients

[2] https://www.sec.gov/comments/s7-22-19/s72219-6610717-202929.pdf

delegate such responsibilities to us precisely because they **do not** want to be directly involved in investment management activities; this certainly includes discussions with portfolio companies with regard to complex issues that potentially impact the long-term performance of their investment portfolio as well as negotiations that determine the disposition of the shareholder proposal.

We do not see how negating the individual right to delegate this task benefits individual investors who do not have the background, expertise, or appetite to conduct such discussions. Companies routinely hire attorneys and other experts to represent them; this proposal denies individual investors this same opportunity. Chairman Clayton has said that "Serving and protecting Main Street investors is my main priority at the SEC"[3], but this proposed rule, with this footnote's provision, denies those same Main Street investors their right to choose an experienced professional to act on their behalf.

Requirement for dialogue commitment

As First Affirmative, when representing our clients, generally prefers to engage the company directly first through means other than a shareholder proposal, our availability to discuss the concerns raised by a proposal is not an issue. We welcome such discussions. Regrettably, there are some companies who do not appear to welcome such discussions. In fact, a primary reason we file resolutions on behalf of our clients is due to a **company's** failure to respond to our request for disclosure and/or dialogue. This proposal is one-sided in favor of companies, and it appears that the companies that don't respond to alternative methods of engagement are poised to be the biggest beneficiaries. Why is the company not also required to meet with the shareholder proponent as well?

Additionally, setting specific times and dates for dialogue seems a day-to-day business matter that would be better left up to the participants to agree upon, rather than dictating such minutia through a formal SEC rule.

Specifically, we ask that:

- The SEC eliminate footnote 70 and clarify that this proposed rulemaking does not set out to negate the right of individuals to designate a representative to act on their behalf.

- Should the final proposal contain a requirement that shareholders agree to dialogue, require companies to demonstrate that they requested dialogue with shareholder proponents **prior** to filing a no action request.

- Provide underlying economic analysis that demonstrates the specific costs and benefits to all parties of restricting a client from delegating authority to conduct corporate engagement related to a shareholder proposal and requiring clients to be directly involved in shareholder proposal discussions.

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[3] https://www.sec.gov/fact-sheets/sec-protects-retail-investors-markets

Proposed filing thresholds based on different holding periods

The proposed increase to the holding size required to file a shareholder proposal in the first ($25,000) and second ($15,000) year with no share aggregation allowed is a major restriction of shareholder rights. Our largest clients often meet the proposed first and second year thresholds for their largest stock holdings. However, for the majority of our clients, participation in the shareholder proposal process would be curtailed without compromising the diversification our firm recommends to manage risk.

These smaller clients on a proportionate basis have as much “skin in the game” as our much larger clients, with those smaller holdings being **proportionately** as important to the achievement of their long-term financial objectives. The first year holding size increase of 12.5 times the current dollar threshold and the second year at 7.5 times the current dollar threshold represents an insurmountable obstacle for many of our clients, but these steep increases in themselves don’t fully illustrate the problem.

As the dollar threshold must be maintained at these threshold requirements during the shareholder proposal process, allowances must be made to account for stock volatility. Therefore, we typically file resolutions on behalf of our clients **only** if a long-term holding is one and a half times to two times the dollar threshold, depending on the stock’s historical volatility. Thus, the $25,000 threshold becomes $37,500 or more to ensure compliance with the rule for the first year. This threshold is well out of reach of the vast majority of our well diversified clients, particularly for clients that have more conservative portfolios, such as those nearing retirement.

To illustrate, we turn to our own client base. The average client size for an account invested in individual stocks as part of a diversified portfolio is within 1% of $500,000.[4] For an average client with a modest risk tolerance, the proportion of their well – diversified portfolio devoted to US stocks is $210,000.

Balanced Growth	***Allocation***	***Average Client***
Large-cap US equity	27%	$ 135,000
Small/mid-cap US equity	15%	$ 75,000
International equity	18%	$ 90,000
REIT	10%	$ 50,000
Fixed income	28%	$ 140,000
Cash	2%	$ 10,000
Total	100%	**$ 500,000**

Our typical client portfolio holds in excess of 100 stocks, but for purposes of this illustration we use a **bare minimum** diversification requirement of no more than 5% exposure to a single US stock. Even at this diversification level, our average client would hold no more than $10,500 in any given stock, and so under this proposed rule no holdings would meet the minimum holding requirement

[4] Average account size varies by the custodian holding the assets: $504, 955 and $495,208 as of January 22, 2020

in the first two years of ownership without significantly compromising diversification. In fact, only clients with more than $1.75 million in assets under management in a balanced growth portfolio could do so without compromising diversification.

In reviewing the proposals we filed on behalf of clients in 2019, NONE of the thirteen shareholder proposals we filed on behalf of clients could have been filed until year three, based on holding periods at the time of filing. These proposals were no less valid concerns of our clients in year one and year two of their holding period. Seven proposals led to constructive dialogue with the companies, and the negotiated withdrawals that ensued in many cases resulted in enhanced disclosures that stand to benefit all shareholders and improve corporate governance practice. Four proposals achieved over 30% support, and one earned over 40% support-a strong indication that the issues raised by these proposals are of material concern to a substantial number of shareholders, and therefore worthy of consideration, regardless of the size or holding period of the investor.

The proposed rulemaking states that

> “A shareholder’s demonstrated long term investment interest in a company may make it more likely that the shareholder’s proposal will reflect a greater interest in the company and its shareholders, rather than an intention to use the company and the proxy process to promote a personal interest or publicize a general cause.”

Assuming this general statement is true, and that this proposed rule is intended to prevent shareholders from using the proxy process “to promote a personal interest or publicize a general cause”, it does not do so. It only prevents smaller investors from doing so — while at the same time preventing smaller investors from presenting legitimate proposals. There should be **no distinction** between a shareholder holding $25,000 or more, $15,000, or a lesser amount.

Assuming the SEC mission of investor protection extends to all investors equally, any restriction to filing shareholder proposals should create a relatively even playing field for investors, rather than creating two classes of investor-with one group (larger investors) having more rights than the other (smaller investors). The basis for allowing a larger shareholder to file a resolution in the first two years while excluding smaller shareholder with identical concerns and the same relative exposure is arbitrary and capricious.

Prohibiting share aggregation to meet filing thresholds

The SEC, in removing the ability of individual shareholders to aggregate shares for the purposes of meeting the filing requirements, further disenfranchises smaller investors. Mutual funds, for example, may easily meet the requirements set forth by this proposal by virtue of aggregating the investments of many individual investors together, and yet individual investors **outside** of this institutional framework are not allowed to aggregate shares. We believe that this is an inappropriate distinction. Furthermore, investment advisors like First Affirmative should be able to represent like-minded clients and act on their collective behalf just as an investment advisor managing similar clients is able to do via a mutual fund structure.

We offer the following alternatives to update requirements in a straightforward manner without introducing an approach that disenfranchises smaller investors:

- Set a single dollar threshold that all shareholder proponents must meet, with no discrimination between investors as determined by holding period. This threshold should be a reasonable increase that continues to be indexed for inflation, in line with the table on page 19 of the proposed rulemaking that projects a threshold of $3, 152 — the inflation-adjusted level calculated from the 1998 threshold set at $2, 000.

- Should the commission choose to establish different holding requirements depending on the length of time the shares are held, aggregation of shares should be allowed — particularly in order to meet the higher amounts required to file in year one and year two. The proposed rulemaking points out that aggregation of shares causes costs to be incurred by companies, but this is also the case for the shareholder proponents. Such aggregation activity on the part of individual investors is indication that these investors have a long-term investment interest, and such aggregation would partially mitigate the adverse impacts of this rulemaking on less wealthy investors.

Proposed resubmission requirements

Most proposals filed by First Affirmative that have gone to a vote exceed proposed thresholds and we therefore defer to shareholders more directly impacted by these provisions to provide commentary on this issue. However, we would point out that this rulemaking is particularly damaging to shareholder's ability to raise concerns about emerging issues and, once again, impacts **all** shareholders, including our many clients that authorize us to vote their proxies in accordance with customized guidelines.

Many proposals start with minimal support, but those that prove their business case over time are often withdrawn after successful negotiation or go on to win substantial, and even majority support. The proposed changes to the resubmission thresholds would have, if currently in place, eliminated many proposals that over time proved worthy of consideration and adoption.

For example, a proposal to granting investors the right to nominate board directors to appear on the proxy received only 4.4% support the first year it was filed at Netflix, but won a majority vote when refiled two years later in 2015. The Board enacted proxy access in 2019. The same patterns applied at other companies on this same issue before achieving majority support and eventual company adoption.

Many proposals that garnered substantial support upon re-filing would have been excluded if the second and third year thresholds were raised to 15% and 30%. Among them (2011-2018): six proposals calling for an independent board chair and twelve proposals seeking disclosure of political contributions or lobbying payments[5] — two governance practices that we strongly support.

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[5] https://corpgov.law.harvard.edu/2018/12/04/clearing-the-bar-shareholder-proposals-and-resubmission-thresholds/

Selected concerns regarding the economic analysis

A major consideration we believe is not properly analyzed in the economic analysis of this proposal is the potential benefit derived by companies and their shareholders from addressing shareholder proposals that would be eliminated by the enactment of this rule. The economic analysis focuses primarily on the savings generated by exclusion of proposals generally, using average shareholder proposal cost estimates that have been subject to criticism. [6]

The SEC notes in its economic analysis that some of the costs to companies involve a degree of management discretion as to the level of expenses incurred, and that there is disagreement about the level of such expenses that is value-enhancing. However, there is no attempt to distinguish between costs that are **necessary** in order to comply with SEC rules and discretionary costs that are incurred because the company **chooses** to challenge a proposal, often with the assistance of legal counsel. The number of such no action requests that are not granted by the SEC is not inconsequential. For example, between October 1, 2018, and July 31, 2019, the Staff of the SEC's Division of Corporation Finance issued 231 responses to no-action requests under Rule 14a-8. Staff did not concur in a company's intention to exclude a proposal in response to 60 of these requests (32.3% of responses to non-withdrawn requests)[7]. There is no indication that consideration has been given to determine how unproductive no action requests impact the cost benefit analysis.

Given that shareholder proposals are precatory in nature, expending significant resources to "fight" the appearance of proposals on the proxy seems an expensive and unproductive exercise in many cases. There has been no attempt to evaluate the overall costs of all parties engaging in the no action process versus simply allowing a proposal to appear on the proxy and be voted on by shareholders. Regardless of the merits of the proposal or the outcome of the vote, the vote serves as an important communications device between investors in aggregate and the companies in which they invest **without** compelling the company to take any action at all.

We agree with comments[8] made in the recommendation of the Investor-As-Owner Subcommittee of the SEC Investment Advisory Committee Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals regarding the economic analysis:

> "There is a marked contrast between lengthy recitation of problems that proxy advisors and shareholder proposals "may" create, on the one hand, and a negligible discussion of their benefits, on the other hand. The imbalanced presentation deprives the public of an adequate foundation for commenting on the proposals. The presentation fails to draw on the extensive discussion and evidence of the benefits of proxy advisors and shareholder proposals at the SEC's Proxy Roundtable…"

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[6] https://corpgov.law.harvard.edu/2017/06/15/the-dangerous-promise-of-market-reform-no-shareholder-proposals/
[7] https://www.mofo.com/resources/insights/190718-shareholder-proposal.html
[8] https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-proxy-advisors-shareholder-proposals.pdf

We urge the Commission to carefully consider the Investor- As-Owner Subcommittee comments. We echo, in particular, the second overall recommendation of the Subcommittee, asking that the SEC revise and republish the process for balance in compliance with SEC guidance. We believe this recommendation outlines steps that need to be taken for our priority concerns to be addressed:

"The SEC should revise and re-issue the rule proposals to:

- Present a balanced assessment of proxy advisors and shareholder proposals.
- Comply with SEC guidance on the economic analysis included in the releases.
- Present evidence supporting the need for the proposals, rather than stating simply that problems "may" exist.
- Address reasonable alternatives to the proposed changes and why they are not more likely to achieve the stated goals of the proposals at a lower net social cost.
- More fully address how the PA/SP actions particularly affect small and mid-sized investment managers and "Main Street" shareholders.
- Discuss the risk that the proposals could impair the ability of proxy advisors to sustain their businesses, or new competitors to enter the business, which could result in increased monopoly power and more–not fewer –one-size-fits-all voting outcomes."

First Affirmative supports alternative rulemaking approach

First Affirmative strongly supports alternative SEC action that we believe would significantly reduce the need for shareholder proposals without reducing shareholder rights — mandating consistent, comprehensive and comparable ESG reporting from public companies, as was requested in a petition[9] for rulemaking in late 2018 by investors representing over $5 trillion in assets.

The petition:

- Calls for the Commission to initiate notice and comment rulemaking to develop a comprehensive framework requiring issuers to disclose identified environmental, social, and governance (ESG) aspects of each public-reporting company's operations;
- Lays out the statutory authority for the SEC to require ESG disclosure;
- Discusses the clear materiality of ESG issues;
- Highlights large asset managers' existing calls for standardized ESG disclosure;

[9] https://www.sec.gov/rules/petitions/2018/petn4-730.pdf

- Discusses the importance of such standardized ESG disclosure for companies and the competitive position of the U.S. capital markets; and

- Points to the existing rulemaking petitions, investor proposals, and stakeholder engagements on human capital management, climate, tax, human rights, gender pay ratios, and political spending, and highlights how these efforts suggest, in aggregate, that it is time for the SEC to bring coherence to this area.

Investors file shareholder proposals primarily to obtain ESG policy and performance disclosure from the companies in which they invest. Indeed, the largest of institutional investors, including BlackRock[10], are increasingly demanding ESG disclosures from their portfolio companies as the long-term performance implications of neglecting ESG issues becomes more apparent.

For smaller investors in particular, the shareholder proposal process in its current form is an effective, cost-efficient way to solicit this increasingly essential ESG information from their portfolio companies in the absence of voluntary disclosure. SEC action to ensure that **all** investors have access to comprehensive, standardized ESG disclosure from public companies would reduce the necessity of filing shareholder proposals.

Sincerely,

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Cc:
The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission
Mr. Rick Fleming, Investor Advocate, Office of the Investor Advocate, SEC
Chairwoman Maxine Waters, House Financial Services Committee
Doug Lamborn, US Representative, Colorado District 5
Michael Bennett, US Senator, Colorado

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