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February 3, 2020

Via Electronic Submission

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice (RIN: 3235-AM50; Release No. 34-87457; File No. S7-22-19)

Dear Ms. Countryman:

Hermes Equity Ownership Services Limited ("**Hermes EOS**") appreciates the opportunity to comment on the Securities and Exchange Commission's (the "**Commission**") proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice[1] (the "**Proposal**" or "**Proposed Amendments**") regarding proposed amendments to 17 CFR 240.14a-1(l) ("**Rule 14a-1(l)**"), 17 CFR 240.14a-2 ("**Rule 14a-2**"), and 17 CFR 240.14a-9 ("**Rule 14a-9**") under the Securities Exchange Act of 1934 (the "**Exchange Act**").

Hermes EOS is a leading stewardship services provider. Our engagement and related activities enable pension funds and other long-term institutional investors to be more active owners of their assets, through constructive dialogue with companies on long-term value creation, including environmental, social and governance risks and opportunities. Hermes EOS provides enhanced proxy voting recommendations as well as corporate engagement services.[2] We believe that both services are essential to build a global financial system that delivers improved long-term returns for investors and their beneficiaries, as well as more sustainable outcomes for the environment and society. Hermes EOS provides stewardship services on assets of approximately $877 billion as of December 31, 2019.

As a leading provider of both corporate engagement and enhanced proxy voting recommendation services, Hermes EOS looks forward to a constructive dialogue among the Commission, investors,

and other stakeholders as the Commission considers and refines the Proposal. To that end, this letter sets forth our comments on the Proposal and our recommendations regarding steps that the Commission could take to promote greater investor stewardship and responsible investing more generally.

I. Executive Summary

Hermes EOS is encouraged by the Commission's concern regarding the proxy voting process and investor engagement generally. In particular, we appreciate the Commission's efforts to ensure the availability of more accurate, transparent, and complete information on which institutional investors and their advisers make their voting decisions. We also support the Commission's stated goal that proxy voting advice businesses should be transparent with their clients about the processes and methodologies used to formulate the advice given, especially when these businesses provide advice to investment advisers and other agents that make voting determinations on behalf of institutional investors.

However, we have significant concerns with the Proposal and believe that, overall, it will hamper engagement by institutional investors and their investment advisers, rather than facilitate it. We believe that several aspects of the Proposed Amendments, as drafted, will impede, rather than promote, the communication of accurate and unconflicted information among issuers, investors, and investors' agents. We also believe that the Proposal's focus on procedural requirements for proxy advisory firms is not the most effective method to promote broader and better-informed corporate engagement by investors.

Additionally, we believe that the costs associated with the Proposal could be significant and may currently be underestimated. The Proposed Amendments impose increased costs on proxy advisory firms to run their businesses that, in turn, will inevitably be passed on to institutional investors in the form of increased fees. As such, the Proposed Amendments will harm investors, as opposed to protect them, by significantly increasing the costs associated with engaging proxy advisory firms for assistance in considering proposals and potentially limiting their ability to afford proxy voting advice at all.

Institutional investors hire proxy advisory firms to provide timely, independent analysis to help them make informed and prudent decisions regarding companies owned on behalf of their beneficiaries. The Proposed Amendments will disrupt the relationship between institutional investors and their independent advisers by imposing a requirement that proxy advisory firms first provide their advice and analysis to the issuers *about whom they have been hired to provide independent proxy voting advice*. This process is likely to compromise the independence of advice provided by proxy advisory firms to institutional investors because of potential legal risks, truncate the amount of time for institutional investors and their advisers to consider proposals, and hinder the opportunity for substantive, meaningful engagement between investors, their advisers and companies.

In our opinion, the Commission could more effectively promote a culture of stewardship, and address the current low level of constructive investor engagement with corporate issuers by

providing a clearer definition of the responsibilities of institutional investors to vote proxies and engage with issuers in a manner that promotes sustainable, long-term returns in the interests of ultimate beneficiaries. Consequently, we respectfully recommend that the Commission withdraw the proposed pre-review requirement imposed by proposed paragraph (b)(9)(ii) of Rule 14(a)-2 entirely.

However, if the Commission elects to retain some form of the proposed pre-review process, we believe that certain corrective changes to the Proposal should be made. These changes include:

- Revising the text of proposed Rule 14a-2(b)(9) to create a safe harbor from liability for the provision of subjective analysis, assessments, and judgments;
- Revising the text of proposed Rule 14a-2(b)(9)(ii)(B) to provide that the additional two business day final notice period is available only to those issuers that provide feedback in writing to proxy advisory firms in accordance with Rule 14a-2(b)(9)(ii)(A);
- Revising the text of proposed Rule 14a-1(l)(iii)(A) to more clearly exclude persons who provide certain other forms of advice that do not constitute solicitation activities, such as engagement services, from the proposed definition of "solicitation";
- Clarifying in the adopting release of the Proposed Amendments or interpretive guidance that firms or affiliates that engage in proxy advisory services as well as other lines of business, will not, through the provision of proxy advisory services, cause their other businesses to be subject to the federal proxy rules;
- Consulting with market participants to settle on a more practicable and value-adding pre-review process requirement; and
- Considering potential alternative solutions to increase transparency about the interactions between proxy advisory firms and issuers, such as enhanced disclosure and communication through best practice guidelines for shareholder voting research through industry groups or regulatory requirements similar to those required under the European Shareholder Rights Directive.

II. The Commission's Regulatory Objectives

A. Stewardship and Corporate Engagement

There is a consensus among global regulators in major economies, academics, and key participants in financial markets that institutional investors can and should play an important role in the governance of corporations by purposefully voting shares and engaging with executives and boards at the companies that they own.[3] Active involvement of institutional investors in corporate governance is recognized by the 2015 G20/OECD Principles of Corporate Governance[4] as an effective pathway to improved corporate governance, and long-term institutional investor engagement at a corporate level is a practical way to enhance issuer performance and foster economic growth.[5] These activities, now often referred to as "stewardship,"[6] have been shown to

protect and enhance the value of corporate enterprises, thus contributing to long-term sustainable wealth creation and economic welfare benefiting directly and indirectly hundreds of millions of investors and other stakeholders, particularly workers saving for retirement.[7]

Consequently, policymakers, regulators, corporate governing boards, and institutional investors all increasingly agree that shareholder engagement should encompass much more than corporate governance discussions related to resolutions at shareholder meetings and proxy advisor research and recommendations.[8] Proxy voting can be supplemented through the practice of engaged stewardship to help improve corporate performance over the long-term. Unlike rote voting based on the generic research and recommendations of proxy advisory firms, shareholder engagement involves a meaningful, long-term, and constructive dialogue between companies and institutional investors that provides advantages to companies and investors alike, as institutional investors "help achieve long-term sustainable value" and to "help curb excessive risk taking."[9]

These are laudable goals, and they conform to the widely recognized fiduciary obligations of institutional investors and investment advisers not only to ensure that proxies are voted on a timely basis as a procedural matter, but also more broadly to ensure that ownership rights are exercised in a prudent and constructive manner in the interests of plan participants, fund shareholders, and other beneficial owners for whom institutional investors act as fiduciaries.[10] Rather than introducing burdensome procedural requirements on periodic shareholder votes purportedly to enhance aspects of the proxy process, we propose instead that the Commission should promote constructive, long-term engagement between issuers and institutional investors that is not limited to the narrow framework of proxy voting.

B. Industry Efforts to Promote Stewardship

There is an established view that, at present, there is a dearth of high quality dialogue between institutional investors and their agents, on one hand, and corporate executives and boards, on the other, regarding the long-term creation and maintenance of value. One recent survey highlighted the importance to investors of receiving nonfinancial, environmental, social and governance information that has received a "company's top-level approval by, for example, its board or audit committee" and as such, the ongoing need for board level engagement with a company's largest investors, or their representative, is essential to long-term corporate growth. [11] The dearth of high-quality dialogue between executives and boards and institutional investors ultimately impacts many facets of corporate governance, including but not limited to the submission of proposals in the form of annual meeting resolutions.

The U.S. institutional investor community is taking steps to close this gap. Some of the largest U.S. institutional investors have come together to form the Investor Stewardship Group ("**ISG**") which now includes more than 60 U.S. and international institutional investors with combined assets in excess of $31 trillion in the U.S. equity markets.[12] The ISG has developed a framework for U.S. Stewardship and Governance comprising a set of stewardship principles for institutional investors and corporate governance principles for U.S. listed corporations. The ISG framework emphasizes shareholder engagement dialogue while stressing board accountability to shareholders through oversight, financial results, and governance best practices. [13] The ISG Framework works

as a tool for both institutional investors and companies, to promote mutually agreeable objectives, including the codification of good corporate governance and the affirmation of institutional investors' engagement responsibilities. The Framework is especially useful in light of the general lack of legislation surrounding disclosure of long-term corporate value creation, such as environmental, social and governance concerns.[14]

C. Recognizing the Difference Between Stewardship and Shareholder Activism

As the institutional investor community continues to organize around the promotion of greater stewardship (consistent with investor fiduciary duties), we are concerned that critical and constructive dialogue between companies and their shareholders will be viewed by regulators through the lens of "shareholder activism," rather than partnership among institutional investors, their advisers, and corporations in support of sustainable long-term wealth creation. The industry efforts noted in the preceding section demonstrate that *not all communications between shareholders and executives and boards relate to proxy votes or shareholder resolutions*. As a provider of both stewardship services and proxy voting recommendation services, we recognize that many institutional investors and investment advisers engage in dialogue with executives and boards outside the proxy voting context. We believe that approaching the topic of shareholder engagement from the perspective of existing regulations designed to oversee the proxy solicitation process will impede, rather than promote, constructive dialogue and stewardship. Such regulatory limitation of constructive dialogue and stewardship will, in our view, actually encourage more "shareholder activism" and proxy contests.

In light of the widely held view that enhanced stewardship and investor engagement benefit companies, their investors, and society as a whole, we respectfully submit that the Commission's overriding regulatory objective should be the *promotion* of long-term, constructive shareholder engagement, rather than the imposition of procedural requirements on proxy votes.[15] We believe that rules that address the proxy voting process should expand and encourage engagement activities by institutional investors, with the goal that these activities become an integral part of the activities of institutional investors, rather than a periodic consideration prompted by shareholder meetings. More direct and well-informed dialogue between issuers and institutional investors and their advisers, in turn, could ensure that each company's specific circumstances are taken into consideration by fiduciaries charged with exercising shareholder rights in the best interests of retirees and other investors. Unfortunately, we believe that the imposition of burdensome procedural requirements on proxy advisory firms does not advance this purpose, and instead will inhibit effective shareholder engagement.

III. The Role of Proxy Advisory Firms

A. The Market for Proxy Advisory Services

Proxy advisory firms play a useful role in facilitating voting and related engagement activities of institutional investors, many of whom have invested in thousands of companies around the world. Proxy advisory firms owe express obligations to their clients in exchange for fees under detailed contracts. These services are generally provided to institutional investors, ultimately for the benefit

of their beneficiaries. It is our view that these beneficiaries are the true main street investors. In our experience, institutional investors are generally satisfied with the services provided by proxy advisory firms, and critically, it is our understanding that investors very rarely find factual errors in the research provided by proxy advisory firms.

We are concerned that the Commission's Proposal will disrupt proxy advisory relationships that have developed into an effective process, underpinning the stewardship ecosystem that has developed since the Global Financial Crisis. As such, we believe that the Proposal is not only unnecessary, but will actually introduce significant risks to this process that are not currently present. These risks include inefficiencies in the delivery of services and compromised independence of proxy advisory firms, as a result of increased enforcement and litigation risks.

We also expect that the Proposed Amendments, if adopted, would result in reduced competition from the likely withdrawal of the remaining smaller proxy advisory firms from the market. As the Commission is well aware, the U.S. House Committee on Financial Services ("**Committee**") has on many occasions voiced concern with the concentration of market power in the two largest proxy advisory firms. In the words of former Committee Chairman Hensarling, "The proxy advisory firm duopoly is in serious need of reform and SEC attention. The market power of proxy advisory firms demands greater accountability for these firms' actions and the information that they provide institutional investors."[16] The issuer pre-review aspects of the Proposal represent a barrier to entry that will likely cement the current duopoly of providers, contrary to the express concerns of the Committee. In similar past situations, such as the regulation of credit rating agencies, reform efforts of Congress and of the Commission have in fact resulted in similar barriers to entry that suppress competition, a dynamic that has also been recognized by the Committee.[17]

B. Interference with Agency Relationships

When considering the Proposal, we respectfully recommend that the Commission engage in a more careful consideration of commercial agency as contrasted with proxy solicitation. We believe that the fundamental purpose of regulating proxy solicitation is to provide order and transparency to the organization and aggregation of groups of investors where no commercial agency between those investors exists.[18] The classic case is where an issuer and a dissenting investor group wage a proxy contest for control of a company. Each hires a proxy solicitation firm to gather votes, or proxies for these votes, from investors. In this case, neither the company nor the dissenting investor group has a commercial agency relationship with the other investors that are the target of the solicitation. The Commission has long recognized that the purpose of federal laws and its own regulations regarding proxies is to protect investors from abuse by "promiscuous solicitation" of proxies, "irresponsible outsiders" seeking corporate power, and "unscrupulous" management "concealing or distorting facts."[19] These concerns are simply not present when the investor has hired a proxy advisor for the express purpose of providing independent advice on these very issues.

We believe the need for regulation of the voting organization of disparate and disaggregated investors is clear. However, we do not believe that the Commission has articulated the benefit to be gained from, in our view needlessly, applying proxy solicitation rules where commercial agency already exists between an investor and its advisors. Rather than providing for enhanced

transparency, we believe the Proposal will have the effect of impairing the efforts of institutional investors to *protect themselves and their beneficiaries* through freely elected commercial agency by compromising the independence of the investor's chosen agent.

C. Distinguishing Between the Benefits of Transparency and the Risks of Issuer Pre-Review

As a general matter, we support greater transparency around the governance and operations of proxy advisory firms, and particularly stronger rules around conflicts of interest. However, with respect to the issuer pre-review aspects of the Proposal, we feel that there are more effective methods, and with regard to conflicts, much more targeted routes, to achieving the Commission's specific, desired regulatory outcomes. Below we recommend alternatives that would not add unnecessary financial or operational burdens to the voting chain, compromise the independence of proxy advisory firms' research or reduce competition in the proxy advisory market.

IV. Impact of the Proposed Amendments

The Proposed Amendments, specifically the registrant pre-review requirement imposed by paragraph (b)(9)(ii) of Rule 14(a)-2, could significantly damage the developing stewardship ecosystem in the U.S. by making the timely delivery of proxy advice to institutional investors impractical and adding significant costs.[20] The Proposed Amendments would also likely compromise the independence of proxy advisory firms. These drawbacks are not balanced by any meaningful benefit to investors from involving an issuer in the production and publication of analysis about that issuer in the Proposal, given the additional litigation risks catalyzed by the Proposal. The proposed pre-review process does not foster constructive dialogue between companies and institutional investors and their advisers, and we believe that it is more likely to impede meaningful engagement by investors than promote it, given the proposed process. We discuss these and other impacts of the Proposal below.

A. Legal and regulatory risks related to qualitative assessments and subjective judgments of proxy advisory firms will have a chilling effect on the independence of customary research and recommendations.

We strongly believe that the Commission's regulation of proxy solicitation must not compromise in any way the independence of advice provided by proxy advisory firms to investors and their advisers. The Proposed Amendments will most likely have this effect. If investors considered routine prior review of proxy advice by issuers desirable, the market would have provided such an incentive already. In our view, there is no need to mandate this by law in the absence of such demand. We also expect that issuers themselves would be reluctant to review potentially hundreds of different versions of proxy research and related voting research and recommendations for each and every shareholder meeting based on the customized voting policies of the more advanced institutional investors. We also believe that, fundamentally, customized policies and associated recommendations represent the intellectual property of institutional investors and therefore should not be disclosed by proxy advisors to issuers without the relevant proxy advisor clients' prior consent.

We have stated below our key concerns with the pre-review aspect of the Proposal. While some of the below concerns could be mitigated to some degree, the structure of the Proposed Amendments is such that they are likely to compromise the independence of proxy advisory firms in ways that cannot be fixed through minor adjustments. Our key concerns are:

- Paragraph (b)(9)(ii) imposes on a proxy advisory firm the *obligation* to provide registrants about whom it is hired to provide impartial advice an opportunity to comment on that advice before the advice is delivered by the proxy advisory firm to its client. Where the proxy advisory firm's advice supports a vote consistent with the registrant's proposals, the registrant would reasonably be expected to *not* comment on the proposal. However, it is foreseeable and expected that, based upon agreed voting policies, proxy advisory firms will also frequently recommend that their clients vote *against* proposals supported by executives and boards.

- Where a vote against executives and boards is recommended, executives and boards may use the opportunity to provide argumentative comments on the proposed proxy advice, including comments that blur the line between (i) objections to factual inaccuracies and (ii) objections to analysis that is developed in good faith, but that paints a negative picture of the composition or performance of the company's current executive body and board, and other governance aspects. While these recommendations are based on the advisor's judgment following analysis instructions and standards agreed to in advance with the investor client, issuers may challenge the recommendations based on contrary opinions that are presented as factual inaccuracies.

- While the process presents a beneficial opportunity for issuers to correct factual inaccuracies, it also presents a detrimental opportunity for issuers to object to analysis under the guise of "corrections." These objections in turn create the foreseeable risk that the issuer will assert that the proxy advisor made material misstatements in proxy voting advice,[21] or did not satisfy the other requirements of Rule 14-2(b)(9). Proxy advisory firms may consciously or unconsciously submit to specious arguments offered by the issuer, and compromise the independence of their analysis. Institutional investors and proxy advisors alike have recognized that the Proposed Amendments may be viewed as an "invitation" for issuers to sue proxy advisors that do not acquiesce to all comments offered by issuers in the pre-review process.[22]

- In all scenarios, proxy advisory firms and their counsel are likely to spend substantial time arguing with executives and boards when the proposed advice does not support the position of the executives and the board. Under the Proposal, these arguments must occur before the advisors are even permitted to share the advice with their clients, with potentially significant direct and indirect costs in the form of legal fees and lost time that could be spent analyzing proxies on behalf of clients. The protective provisions of Rule 14-2(b)(9)(iv) and other provisions of the federal securities laws that protect proxy advisory firms acting in good faith will not protect against these costs, and these costs will operate as a disincentive to recommend a vote against executives and boards in all cases.

These obvious and foreseeable drawbacks are not, in our view, balanced by meaningful benefits to investors. The Proposal states that the Commission believes that this requirement would "reduce the likelihood of errors, provide more complete information for assessing proxy advisory firms' recommendations, and ultimately improve the reliability of the voting advice utilized by investment advisers and others who make voting determinations, to the ultimate benefit of investors."[23] While the likelihood of errors may be reduced in some cases, we disagree that the Proposal will improve the reliability of the voting advice.

- As noted above, we are not aware of concerns within the investment industry that investors frequently find factual errors in the research provided by proxy advisory firms. Furthermore, to the extent that the pre-review requirement is designed to address factual errors, the Commission could have proposed a rule that requires the sharing of factual information and data used by a proxy advisory firm in preparing proxy research and recommendations, rather than all research and recommendations, which it intends to provide to its clients (which may not include the data and factual information on which the research and recommendations are founded).

- The compromised independence of proxy advisory firms would have a greater negative impact on the "reliability" of voting advice than any positive impact that could reasonably be expected from requiring issuer pre-review of that advice.

- With respect to the interest in providing more complete information for assessing proxy advisory firms' research and recommendations, we believe that this goal is addressed through the requirement that proxy advisory firms disclose to their clients' information regarding material aspects of their advisory process and material conflicts of interest, which we generally support. We do not believe that this goal is achieved (or that the Proposal provides any argument that it would be achieved) by requiring that proxy advisory firms provide their advice to issuers for review and comment, in the manner proposed, before providing that advice to investor clients.

B. <u>The Proposal will add costs to the U.S. voting system, which most likely will be passed on to institutional investors and thus have a negative impact on the returns of those investors and ultimately their beneficiaries.</u>

The Proposed Amendments will impose both direct and indirect costs on proxy advisory firms. We believe that these costs will be passed on to institutional investors and thus negatively impact their net investment returns. Under the Proposed Amendments, proxy advisory firms will bear costs associated with, among other things:

- the proposed requirement that issuers and other soliciting persons be given an opportunity to review and provide feedback on the proxy voting advice and receive a final notice of voting advice, including: "(i) modifying current systems, or developing and maintaining systems to track the timing associated with these new requirements; (ii) modifying current systems and methods, or developing and maintaining new systems and methods to share the proxy voting advice with registrants and other soliciting persons; and (iii) delivering

draft voting advice to registrants and other soliciting persons for their review and feedback"[24];

- "processing and considering the registrant's or other soliciting person's feedback and making determinations as to whether changes to the proxy voting advice are necessary or appropriate based on such feedback"[25] and

- the proposed conflicts of interest disclosure requirements, including "(i) reviewing and preparing disclosures describing their conflicts; (ii) developing and maintaining methods for tracking their conflicts" with enough "specificity to enable its proxy advisory clients to adequately assess the objectivity and reliability of the proxy voting advice"; "(iii) seeking legal or other advice; and, (iv) updating their voting platforms".[26]

Each of these proposed requirements make it more costly and more expensive for proxy advisory firms to run their businesses. As discussed elsewhere herein, we believe that the benefits of enhanced conflict of interest disclosures outweigh the costs associated with this requirement. However, the costs of issuer pre-review, though difficult to ascertain, are likely to be material, including both the direct costs of establishing the mechanics of millions of communications subject to the Proposal, and indirect costs associated with increased legal and regulatory risks that arise from this requirement.[27] In order to make up for these increased costs, proxy advisory firms will likely increase the fees they charge to institutional investors in exchange for proxy advice and voting services. This is particularly troubling when considered in concert with the fact that small institutional investors tend "to rely more heavily on the research and recommendations offered by proxy voting advice businesses"[28] due to their limited funds and resources which, in turn, limit their ability to conduct their own independent research on company proposals for shareholder meetings. As such, the Proposed Amendments, while purporting to protect investors by "ensuring that information provided by proxy voting advice businesses enables investment advisers to make informed voting determinations on investors' behalf,"[29] will actually harm investors by significantly increasing the costs associated with engaging proxy advisory firms for assistance in considering proposals and potentially limiting their ability to afford proxy voting advice at all.

C. <u>The Proposal will reduce the amount of time available for institutional investor (rather than proxy advisor) engagement with companies around voting.</u>

The review periods imposed by proposed Rule 14a-2(b)(9)(ii) would significantly reduce the amount of time available to investors to review advisory proposals and to undertake meaningful engagement with companies.

- Under proposed paragraph (b)(9)(ii)(A), depending on how far in advance of a shareholder meeting definitive proxy materials are filed, issuers would be granted either three or five business days to review and provide feedback on any proxy voting advice in advance of its release. While calendar days are used to determine how far in advance of a shareholder meeting particular proxy materials are filed, the amount of time granted to issuers to review proxy advice is based on business days. Consequently, the time investors would otherwise have had to review any voting advice is truncated.

- Under paragraph (b)(9)(ii)(B), proxy advisory firms are required to provide issuers with a final notice of any voting advice at least two business days in advance of delivering such advice to clients, even if an issuer elected not to comment on a proxy the proxy voting advice provided pursuant to Rule 14a-2(b)(9)(ii)(A). This means that two levels of delay are imposed by the Proposed Amendments before advice can finally be presented to investors paying for that advice, regardless of an issuer's responsiveness.

The collective impact of these requirements is best shown through an example timeline:

Under current market practice, prior to a shareholder meeting: (1) a proxy advisory firm reviews the proposals to be voted upon at the meeting, researches the relevant issues, and formulates voting recommendations (including for multiple customized client voting policies), (2) voting research and recommendations are then distributed to investors and their advisers, and (3) investors and their advisers review the research and recommendations and make a decision as to how to vote. More sophisticated investors may engage directly with issuers if there are any critical issues that have not been addressed, or if they require more information to make their final voting decision. Each of these steps must be completed during the window of time that begins when an issuer files its definitive proxy materials and closes at the shareholder meeting. This window is typically between 35 and 40 calendar days, but in practice, electronic submission of votes must be completed 11 calendar days prior to the meeting. Currently, proxy advice is typically delivered to investors and their advisers anywhere between 12 and 30 calendar days in advance of the shareholder meeting. In our experience, proxy advice arrives on average 17 calendar days prior to a shareholder meeting.

Under the Proposed Amendments, two additional action items will be required before a proxy advisory firm may distribute its voting research and recommendations: (1) a proxy advisory firm must provide issuers with time to review and provide feedback on the advice, and (2) a proxy advisory firm must provide issuers with a final notice of voting advice before that advice is provided to clients. Assuming that proxy advisory firms will require the same amount of time to formulate recommendations, these additional steps will delay the dissemination of advice to investors and their advisers. Under the Proposal, an issuer that files its proxy materials 45 calendar days in advance of its shareholder meeting is entitled to 5 business days to review the voting advice. Accounting for weekends, this means that *at least* 7 calendar days between when a proxy advisor would otherwise have been prepared to distribute advice to investors and their advisers and when it can do so pursuant to the terms of the Proposal. Following the initial review period, even if a proxy advisor is in a position to finalize its advice on the same calendar day, an issuer is then entitled to an additional 2 business days to review the final voting advice. This could delay the delivery of the advice to investors and their advisers by 4 calendar days when accounting for weekends. Consequently, the time that investors and their advisers are afforded to review proxy advice will be shortened by *at least* 9 calendar days and this assumes that the proxy advisor will require no extra days to implement both deliveries to issuers and for review of issuer comments, which is highly unlikely in reality. Thus, under a *best case scenario*, proxy adviser clients that previously enjoyed 17 calendar days to review and act on proxy advice will typically have 8 calendar days to reach and implement a voting decision, less than half the time afforded to them under the current framework. Accounting for the fact that electronic votes must be submitted 11

calendar days prior to the meeting, many issuers will need to extend the notice period in advance of meetings. Even with this accommodation, investors would have, under a *best case scenario*, less than two weeks to actually consider voting decisions, and, if necessary, to engage with the issuer.

The impact of the Proposed Amendments is even more concerning when considered in light of contested solicitations and shareholder votes in connection with certain mergers and acquisitions. Where an issuer and dissidents are actively contesting a vote, it is often in the best interests of a proxy advisory firm's clients for the proxy advisory firm to only make a voting recommendation shortly before the voting deadline, as the proxy contestants customarily change their positions and disclosures right up until the shareholder meeting. Also in these cases, shareholder meetings are frequently rescheduled to a later date. Similarly, there often will be significant changes to definitive proxy statements for special shareholder meetings that occur shortly before the meeting deadlines. In each of these cases, it is imperative that proxy advisory firms be able to provide their clients with the *latest* research and recommendations given the dynamic realities of proxy contests, but the timelines imposed by issuer pre-review will pressure proxy advisory firms to issue research and recommendations as early as possible.

The delay imposed by the issuer pre-review requirement will meaningfully reduce, to an unreasonable level, the time available for investors and/or their investment advisers to engage in direct dialogue with issuers after receiving research and recommendations from a proxy advisory firm as a basis for their decision-making. Certain issuers may use this time to constructively interact with a proxy advisor, but there is no constraint on an issuer that chooses instead to run out the clock, and the Proposed Amendments do nothing to address the foreseeable risk of disengaged issuers. In our view, not addressing this is a mistake. Furthermore, having interacted with proxy advisory firms, issuers may be less inclined to engage in further discussions with institutional investors once the advice is finally given. Institutional investors and issuers alike that would otherwise be open to meaningful interactions in connection with a shareholder vote will find that the time available to do so has been materially truncated. Overall, we believe that the rules will obstruct engagement by institutional investors and their investment advisers rather than facilitate it.

D. The Proposal will introduce barriers to entry for new proxy advisory firms, suppress competition in the industry, and encourage superficial, "box-ticking" behavior by proxy advisory firms.

The current market for proxy advisory services is characterized by a lack of competition and market share dominance by a duopoly that we believe will be effectively cemented by the implementation of the Proposed Amendments.[30] The Proposed Amendments will foist greater financial burdens on existing smaller market players and create even higher barriers of entry for new market entrants in an industry already under strain from the inability of new and smaller, boutique businesses to effectively compete with the two established proxy advisory firms.[31] The Proposal will operate to exclude new entrants from the proxy advisory industry and make the business uneconomical for all but the largest proxy advisory firms. As we alluded to above, issuers may be reluctant to review potentially hundreds of different versions of proxy research and

recommendations for each shareholder meeting based on the customized voting policies of institutional investors. Extrapolating this dynamic to the thousands of U.S. reporting companies, proxy advisory firms that seek to provide services to institutional investors will need to negotiate and enter into thousands of nondisclosure agreements with issuers and establish protocols for pre-review by issuers of well over a million communications of proxy advice, all before actually providing any advice to clients.

The management of an enterprise on this scale cannot reasonably be performed by a startup or boutique business, and naturally lends itself to standardization of both advice and advice delivery models. As the universe of proxy advisory firms narrows, institutional investors will have access to fewer sources of proxy advice, and consequently access to less diversity and specialization in proxy advice. Less diversity and specialization in turn will lead to less informed proxy voting by institutional investors. As we noted above, the Committee has recognized the harmful impact of the current duopoly, and the NRSRO oligopoly clearly demonstrates the foreseeable anti-competitive consequences of this type of regulation.

At the same time, the handful of proxy advisory firms that have adequate scale to remain in the proxy advisory industry will (i) need to devote a greater portion of their resources to the new, cumbersome pre-review process (and thus less of their resources to providing substantive advice to clients), and (ii) be subject to less competition as competitors flee the industry (and new entrants face high barriers to entry). Relieved of competitive pressures to provide a differentiated service, proxy advisory firms will be inclined to provide more generic advice in a standardized form to reduce costs.

The Proposal could in essence turn proxy advice into a utility, in which a monopoly (in this case, a duopoly) exploits economies of scale to deliver a commodity product at a long-term price always higher than the price in a more competitive, less monopolistic market. Utilities may make sense when commodities are delivered over complex, investment-intensive transmission structures or for similar common goods market failures. But we believe proxy advice is neither a commodity nor a common good and the Commission should not impose a complex and cost-intensive delivery process where one does not otherwise exist. If these foreseeable, anti-competitive industry developments do occur as a result of these Proposed Amendments, the commoditization of proxy advice will make it much more difficult for institutional investors to obtain sophisticated advice and insight to inform their fiduciary obligation to vote proxies in the best interests of their beneficiaries, who are the true main street investors. Accordingly, we respectfully recommend that the Commission withdraw the proposed addition of paragraph (b)(9)(ii) to Rule 14(a)-2.

V. Alternative Solutions

We believe that a regulatory approach that recognizes more clearly defined engagement responsibilities of institutional investors, such as considering the role of institutional investors in the governance of corporations that goes beyond proxy voting, rather than approaching investor/company interactions exclusively through increased regulation of proxy advisory firms, is more likely to contribute to an effective stewardship ecosystem in the U.S., creating value for

corporations, investors and beneficiaries. Many other markets, such as the European Union, Japan and the United Kingdom[32] successfully utilize such an approach through, for example, stewardship codes, and regulators in these markets underpin these responsibilities with principles-based regulation.[33]

Potential alternative solutions include enhanced disclosure and dialogue through best practice guidelines for shareholder voting research, which could be accomplished (i) through industry groups such as the Best Practice Principles Group (BPPG),[34] or (ii) through regulatory requirements such as those required under the European Shareholder Rights Directive.[35] In our view, these solutions more effectively advance the laudable goal of greater transparency about the extent of interaction between proxy advisory firms and issuers, as well as about the methodologies employed and information sources used in preparing voting research and recommendations. Both of these solutions are also respectful of and compatible with the diversity in proxy advisory firms' business models and size, as these firms do not represent a rigid, cumbersome, one-size-fits-all approach to the corporate proxy review process.

These alternative solutions are flexible and market-based, enabling the customers of proxy advisory firms to assess which provider can best meet their needs. They impose requirements for increased disclosure and mitigation of conflicts of interest, without imposing cumbersome and costly procedures that are inconsistent with the business models of all but the largest two proxy advisory firms. We ask the Commission to consider adopting our alternative solutions in place of the existing Proposals.

In our view, the conflicts of interest most commonly faced by proxy advisory firms arise from the corporate consultancy services that are offered by certain proxy firms. We believe that a superior and more direct method of mitigating this primary source of conflicts would be to require proxy advisory firms to cease or separate and insulate their corporate consultancy businesses, if they exist, from the core voting-related advisory work performed for and on behalf of institutional investors, and we ask the Commission to consider adopting, instead of the Proposal, rules to enforce such separation (including information barriers).

VI. Specific Comments on the Proposed Amendments

We appreciate the Commission's efforts to "help ensure that investors who use proxy voting advice receive more accurate, transparent, and complete information on which to make their voting decisions,"[36] However, as discussed above, we believe that the Proposed Amendments, in particular the proposed addition of paragraph (b)(9)(ii) to Rule 14(a)-2, are not necessary, are likely to inhibit stewardship and engagement by institutional investors and investment advisers specifically preceding proxy votes, and fail to address the key underlying issues in the investment chain. In light of these concerns, we respectfully recommend that the Commission *not* adopt the Proposed Amendments. However, if the Commission chooses to move forward with the Proposed Amendments, we believe that certain adjustments could mitigate the potential for the damage and unintended consequences discussed above.

A. Safe Harbor for Subjective Analysis and Recommendations

First and foremost, we strongly encourage the Commission to introduce a safe harbor rule to protect proxy advisory firms from legal risks associated with the provision of subjective analysis, assessments, and judgments regarding proposals. As discussed above, there are significant legal risks and costs associated with providing issuers a pre-review of proxy advice, especially where proxy advisory firms intend to provide recommendations to vote against executives and boards. Of particular importance is the protection of subjective statements that do not purport to convey facts from legal challenges as "materially false or misleading statements." We respectfully recommend that the Commission consider revising the text of proposed Rule 14a-2(b)(9) to insert subparagraph (v) as follows, or otherwise revise the Proposed Amendments to achieve this goal:

> (v) A proxy voting advice business shall not incur liability under the antifraud provisions of the federal proxy rules set forth in § 240.14a-9 of this chapter for proxy voting advice that reflects the good faith and reasonable opinion of the proxy voting advice business at the time such proxy voting advice was delivered.

B. Definition of Solicitation

We appreciate that the definition of "solicitation" set forth in proposed Rule 14a-1(l)(iii)(A) would codify an existing Commission interpretation[37] that proxy voting advice provided by proxy advisory firms generally constitutes a "solicitation" subject to the federal proxy rules. However, we believe that the proposed definition is overly inclusive, and should clearly exclude persons that are not engaged in solicitation activity, either under the plain meaning of the word or the Commission's expansive application of the concept for purposes of the application of Section 14 of the Exchange Act and the rules thereunder.

For example, we believe that the reference to "other forms of investment advice" may be interpreted to exclude only advice that would cause a person to be an "investment adviser" as that term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940.[38] Such an interpretation may not exclude communications made in the normal course of business of the following types of entities, among others, from the definition of "solicitation": management consulting firms, broker-dealers, lawyers, accountants, valuation agents, and providers of corporate engagement services. We note that lawyers, accountants and broker-dealers are expressly excluded from the definition of "investment adviser" under Section 202(a)(11) of the Investment Advisers Act of 1940.[39] We do not believe that the Commission intends to capture these sorts of communications within the scope of the Proposed Amendments or proxy rules generally.

In light of these concerns, we respectfully recommend that the Commission consider revising the text of proposed Rule 14a-1(l)(iii)(A) as follows:

> (A) Any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is

solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice for a fee, separately from other forms of advice.

We also recommend that the Commission clarify in the adopting release of the Proposed Amendments that:

- where a proxy advisory firm (i) markets its expertise as a provider of proxy voting advice for a fee, and (ii) engages (directly or through other entities controlling, controlled by, or under common control with the proxy advisory firm) in one or more other forms of business that are marketed as distinct services and for which a distinct fee is earned (each an "**Other Business**"); a communication made by an Other Business would not be considered a solicitation unless the communication made by the Other Business would satisfy the definition of a solicitation absent the affiliation;

- for the avoidance of doubt, where a person that does *not* market its expertise as a provider of proxy voting advice for a fee makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited in connection with, such recommendation will not be considered a solicitation; and

- these exclusions would not apply to a person that seeks to circumvent the requirements of Section 14 and the rules thereunder by engaging in a business the primary purpose of which is to provide research and recommendations to security holders as to their vote, consent, or authorization on specific matters for which security holder approval is solicited, for a fee.

C. Procedural Elements of Pre-Review

Third, we encourage the Commission to reconsider the procedural process set forth in proposed Rule 14a-2(b)(9)(ii) by which proxy advisory firms will be required to provide proxy advice to issuers and other persons conducting a solicitation prior to the distribution of that advice to its clients.

We respectfully request that the Commission consider revising the text of proposed Rule 14a-2(b)(9)(ii)(B) as set forth in the Proposed Amendments to provide that the additional 2 business day final notice period is available only to those issuers that actually provide written feedback or another substantive written response to proxy advisory firms in accordance with Rule 14a-2(b)(9)(ii)(A).

Finally, any review process must be efficient and effective for both investors and for issuers. The current proposals most likely fail both tests. In addition to the recommendation above, we encourage the Commission and its staff to consult closely with both proxy advisory firms and issuers to establish mechanics for the review of proxy advice that are both practicable and value-adding. The specific, prescribed mechanics of the proposed process risk significant interruption of a functioning market for proxy advice. The proposed process should not be rushed into an effective state without meaningful consultation and feedback from the market participants that it will impact.

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Hermes EOS appreciates the opportunity to provide comments to the Commission on the Proposed Amendments. We welcome the opportunity to discuss our views with you in greater detail. If you have any questions or would like additional information regarding this letter, please do not hesitate to contact the undersigned at +44 20 7680 2826 or Timothy Youmans, Regional Lead, North America of Hermes EOS, at (212) 292-1048.

Respectfully submitted,

Hans-Christoph Hirt
Executive Director and Head of Hermes EOS

Appendix A: Summary of suggested changes to the Proposal
cc: The Hon. Jay Clayton, Chairman
The Hon. Robert J. Jackson Jr., Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner
William H. Hinman, Director, Division of Corporation Finance

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[1] Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 17 C.F.R. § 240 (2019).
[2] The enhanced voting recommendation services provided by Hermes EOS are based on our proprietary voting policies, developed over the last 15 years, and focused on resolutions that are particularly important to our clients. Our recommendations are often informed by engagement with senior executives and board members of issuers. For underlying data, analysis and technology, Hermes EOS relies on a large proxy advisory firm. More information regarding our services is available at: https://www.hermes-investment.com/ukw/stewardship/.
[3] *See Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-term Shareholder Engagement*, EUR-LEX, May 17, 2017, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828 ("stating that [e]ffective and sustainable shareholder engagement is one of the cornerstones of the corporate governance model of listed companies, which depends on checks and balances between the different organs and different stakeholders. Greater involvement of shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors, in particular as referred to in the Principles for Responsible Investment, supported by the United Nations. In addition, greater involvement of all stakeholders, in particular employees, in corporate governance is an important factor in ensuring a more long-term approach by listed companies that needs to be encouraged and taken into consideration"); *see also* Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey*, FIN. ANALYSTS J., Mar. 2, 2017, https://ssrn.com/abstract=2925310 (noting that, among the different environmental, social and governance styles, "negative screening is perceived as the least investment beneficial while full integration into stock valuation and engagement are considered more beneficial"); *see also* Andreas G.F. Hoepner et al., *ESG Shareholder Engagement and Downside Risk* 1,5 (AFA, Working Paper, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2874252 (noting that "[d]irect institutional investor engagement

on environmental, social and governance (ESG) issues has become increasingly prevalent in financial markets worldwide" and finding that "investor's ESG engagements are associated with subsequent significant reductions in the portfolio firms' downside risk"); *see also* Robert G. Eccles & Svetlana Klimenko, *The Investor Revolution*, HARV. BUS. REV., May-June 2019, https://hbr.org/2019/05/the-investor-revolution (citing a recent survey of " 70 senior executives at 43 global institutional investing firms, including the world's three biggest asset managers (BlackRock, Vanguard, and State Street) and giant asset owners such as the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), and the government pension funds of Japan, Sweden, and the Netherlands" that found that ESG topics were almost "universally top of mind for these executives" and stating that "[i]nvestors, both active and passive and across asset classes, are seeking deeper levels of engagement with their portfolio companies" and that investors are increasingly taking an "integrative approach" to their investments); *see also* Dimson et al., *Active Ownership*, 28 REV. OF FIN. STUD. 3325, 3326 (2015) (noting that institutional investors, as business owners, "are increasingly exercising their rights to influence the way businesses are managed").

[4] OECD, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE 29-33 (2015), http://dx.doi.org/10.1787/9789264236882-en.

[5] *See id*. at 30 (stating "[t]he effectiveness and credibility of the entire corporate governance framework and company oversight depend to a large extent on institutional investors' willingness and ability to make informed use of their shareholder rights and effectively exercise their ownership functions in companies in which they invest"); *see also* Hoepner et. al., *supra* note 3, at 5; *see also* Dimson et al., *supra* note 3, at 3229 (finding that engagement by institutional investors "attenuates managerial myopia and hence helps to minimize intertemporal losses of profits and negative externalities").

[6] *See* FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE 2020 4,7 (2020), https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf (defining "stewardship" as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society" and noting that "[s]tewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities"); s*ee* also ICGN, ICGN GLOBAL STEWARDSHIP PRINCIPLES 5 (2016) (noting that "at an individual company level stewardship helps to promote high standards of corporate governance which contributes to sustainable value creation, thereby increasing the long-term risk adjusted rate of return to investors and their beneficiaries or clients. At an investor level, stewardship is about preserving and enhancing long-term value as part of a responsible investment approach. This includes the consideration of wider ethical, environmental and social factors as core components of fiduciary duty. In a broader context, stewardship enhances overall financial market stability and economic growth").

[7] Hoepner et. al., *supra* note 3, at 5 (noting that environmental, social and governance engagements "are associated with subsequent significant reductions in" downside risk for investors); *see also* FIN. CONDUCT AUTH., BUILDING A REGULATORY FRAMEWORK FOR EFFECTIVE STEWARDSHIP 11 (2019), https://www.fca.org.uk/publication/discussion/dp19-01.pdf (stating that through the use of stewardship, "asset owners and their asset managers can improve issuers' understanding of their interests and influence corporate strategy to further those interests", which can "contribute to the long-term efficiency and effectiveness of capital allocation throughout the real economy, benefitting investors and society").

[8] This increasing agreement is evidenced by the implementation of stewardship codes around the word, including the United States, the European Union, Japan, the United Kingdom, Canada, Brazil and Italy. *See* Global Stewardship Codes Network, INTERNATIONAL CORPORATE GOVERNANCE NETWORK, https://www.icgn.org/policy/global-stewardship-codes-network.

[9] *See id.*; *see also* Ben W. Heineman, Jr. & Stephen Davis, *Are Institutional Investors Part of the Problem or Part of the Solution?: Key Descriptive and Prescriptive Questions About Shareholders' Role in U.S. Public Equity Markets*, YALE SCH. OF MGMT. (2011), https://web.law.columbia.edu/sites/default/files/microsites/millstein-center/80235_CED_WEB.pdf (stating "[t]here have been increasing calls from both the public and private sectors for institutional investors to play a broad 'stewardship' role by 'engaging' with investee companies to assist in detecting blind spots and in value creation).

[10] *See* Cynthia Williams, Keith Johnson, & Susan Gary, *Comment Letter: Fiduciary Duty Guidance for Proxy Voting Reform*, HARV. L. SCH. F. ON CORP. GOVERNANCE (NOV. 27, 2018),

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https://corpgov.law.harvard.edu/2018/11/27/comment-letter-fiduciary-duty-guidance-for-proxy-voting-reform/ (noting that "[i]nvestor fiduciaries have long known that proxy voting must be managed in accordance with fiduciary duties,"); see also *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*, SEC. & EXCH. COMM'N (June 30, 2014), https://www.sec.gov/interps/legal/cfslb20.htm (stating that "[a]s a fiduciary, an investment adviser owes each of its clients a duty of care and loyalty with respect to services undertaken on the client's behalf, including proxy voting."); *see also* Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879 (Dec. 29, 2016) (stating that "[t]he Department's longstanding position is that the fiduciary act of managing plan assets which are shares of corporate stock includes decisions on the voting of proxies and other exercises of shareholder rights."); *see also* JOHN J. CANARY, FIELD ASSISTANCE BULLETIN NO. 2018-01 (2018), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.

[11] *See Tomorrow's Investment Rules 2.0*, *Emerging risk and stranded assets have investors looking for more from nonfinancial reporting*, ERNST & YOUNG LLP (2015), https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/assurance/assurance-pdfs/EY-tomorrows-investment-rules.pdf?download.

[12] *About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance*, INV. STEWARDSHIP GROUP, https://isgframework.org (last visited Jan. 30, 2020); *see also Signatories*, INV'R STEWARDSHIP GRP., https://dev.isgframework.org/signatories-and-endorsers/ (last visited Jan 30, 2020) (noting that some of the largest U.S.-based institutional investors and global asset managers, such as BlackRock, CalSTRS, State Street Global Advisors, TIAA Investments, T. Rowe Price, ValueAct Capital and Vanguard, are signatories to the ISG framework); *see also* BUS. WIRE, *Investor Stewardship Group Achieves Remarkable Success in its First Year (*Dec. 18, 2018, 9:00 AM), https://www.businesswire.com/news/home/20181218005480/en/Investor-Stewardship-Group-Achieves-Remarkable-Success-Year (finding that there has been resounding support for ISG in the market, as demonstrated by the group's size quadrupling in just one year. Additionally, the ISG framework has been endorsed as "the definitive U.S. corporate governance code").

[13] *See Frequently Asked Questions,* INV'R STEWARDSHIP GRP., https://isgframework.org/faq/ (last visited Jan. 30, 2020).

[14] *See id*.

[15] S*ee also* Hoepner et. al., *supra* note 3.

[16] *See* Joe Mont, *Withdrawal of past guidance signals a contentious start to SEC's proxy process review*, COMPLIANCE WK., Sept. 25, 2018, https://www.complianceweek.com/withdrawal-of-past-guidance-signals-a-contentious-start-to-secs-proxy-process-review/2130.article.

[17] *See, e.g.,* HON. JEB HENSARLING, RISK BASED CREDIT EXAMINATION ACT, H.R. REP. NO. 115-384, at 3 (2017) (stating that "to address the failures exposed by the financial crisis, Subtitle C of Title IX of the Dodd-Frank Act includes many credit rating agency reforms. While some of these provisions may be constructive, several create new barriers to entry and further entrench the type of rating agency oligopoly that has not served investors or the economy well and was the reason that Congress first passed credit agency legislation in 2006").

[18] *See* J. Sinclair Armstrong, Chairman, Sec. & Exch. Comm'n, Proxy Solicitations under the Revised Proxy Rules of the Securities and Exchange Commission (June 4, 1956) (stating that the objective of the Commission in governing proxy solicitations is to "obtain for investors and stockholders the fair disclosure of material facts and to prevent...the dissemination of false and misleading statements"); *see also* Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposed Rule Amendments to Improve Accuracy and Transparency of Proxy Voting Advice (Nov. 5, 2019) (noting that the Commission "aims to enhance the accuracy and transparency of the information that proxy voting advice businesses provide to investors and others who vote on investors' behalf, and thereby facilitate their ability to make informed voting decisions").

[19] *See* Armstrong, *supra* note 18 (stating that "[t]he legislative history of the Exchange Act indicates that the Congress was concerned with the abuse of proxies by seekers of corporate power as well as by management. One of the Congressional reports states that lithe rules and regulations promulgated by the Commission will protect investors from promiscuous solicitation of their proxies, on the one hand, by irresponsible outsiders seeking to wrest control of a corporation away from honest and conscientious corporate officials; and, on the other hand, by unscrupulous corporate officials seeking to retain control of the management by concealing or distorting facts").

[20] *See* Letter from Nichol Garzon-Mitchell, Senior Vice President & Gen. Counsel, Glass Lewis, to Alex Goodenough, Office of Mgmt. & Budget (Jan. 7, 2020) (on file with the Sec. & Exch. Comm'n).

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[21] While proxy advice may be considered exempt from the federal proxy rules information and filing obligations under Rule 14A-2(b), such advice is still subject to the anti-fraud provisions of Rule 14a-9 "as a necessary means of assuring that communications which may influence shareholder voting decisions are not materially false or misleading." *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, *supra* note 1, at 68 (noting that the Commission "has previously stated that the furnishing of proxy voting advice, while exempt from the information and filing requirements, remains subject to the prohibition on false and misleading statements in Rule 14a-9."); *see also* False or Misleading Statements, 17 CFR § 240.14a-9 (stating Rule 14a-9 prohibits any proxy solicitation from containing false or misleading statements with respect to any material fact at the time and in the light of the circumstances under which the statements are made). Additionally, such solicitation must not omit to state any material fact necessary in order to make the statements therein not false or misleading. *See id*. As a result, a proxy advisor may incur liability for misstatements in its proxy advice, including "opinions, reasons, recommendations, or beliefs that are disclosed as part of a solicitation, which may be statements of material facts" for purposes of Rule 14a-9. *See* Commission Interpretation and Guidance Regarding the applicability of the Proxy Rules to Proxy Voting Advice, 17 C.F.R. § 241 (2019).

[22] We are aware of one analysis from a large proxy advisory firm that the burden of the Proposal would be "240x the Commission's estimate." *See* Letter from Nichol Garzon-Mitchel to Alex Goodenough, *supra* note 20, at 15.

[23] *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, *supra* note 1, at 44.

[24] *See id*. at 106.

[25] *See id*. at 107.

[26] *See id.* at 104-105.

[27] While the magnitude of the increased costs associated with the Proposed Amendments is difficult to ascertain at this time, we respectfully suggest that the Commission seek to better quantify both direct and indirect costs imposed on proxy advisory firms as a result of implementation of the Proposed Amendments, including expected costs associated with seeking legal or other advice, reviewing and preparing conflict disclosures, and the delivery and processing of draft voting advice via the pre-review process.

[28] *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, *supra* note 1, at 80.

[29] *See id*. at 10.

[30] *See* Chester S. Pratt, *Proxy Advisory Firms Governance, Failure and Regulation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 25, 2019), https://corpgov.law.harvard.edu/2019/06/25/proxy-advisory-firms-governance-failure-and-regulation/ (stating that "[t]hese two proxy advisory firms heavily influence a substantial portion of the voting power of millions of individual shareholders" and noting that "proxy advisory firms have so much influence because…there are only two major proxy advisory firms"); *see also* James K. Glassman and Hester Peirce, "How Proxy Advisory Services Became So Powerful," Mercatus on Policy Series, Mercatus Center at George Mason University, June 18, 2014 (stating that ISS And Glass Lewis together have a 97% share of the market for proxy advisory services).

[31] *See* Pratt *supra* note 30 (noting that the "proxy advising industry is far from competitive").

[32] *See Global Stewardship Codes Network*, INT'L CORP. GOVERNANCE NETWORK, https://www.icgn.org/policy/global-stewardship-codes-network (last visited Jan. 30, 2020); *see, e.g.,* FIN. REPORTING COUNCIL, *supra* note 6.

[33] *See Q&A on Stewardship Codes*, EY, https://www.ey.com/Publication/vwLUAssets/ey-stewardship-codes-august-2017/$FILE/ey-stewardship-codes-august-2017.pdf (last visited Jan. 20, 2020) (noting that "[s]tewardship codes are a tool for enhancing investor engagement and transparency about how investors define and discharge their ownership and governance responsibilities. These codes, which have been developed by regulators or investors, aim to clarify basic governance expectations and responsibilities in ways that enhance the quality of investor-company dialogue and contribute to the long-term success of companies").

[34] THE REVIEW COMMITTEE - BEST PRACTICES PRINCIPLES GROUP, REVIEW AND UPDATE OF THE BEST PRACTICE PRINCIPLES FOR PROVIDERS OF SHAREHOLDER VOTING RESEARCH & ANALYSIS (2019).

[35] *See Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies*, EUR-LEX (2007), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2007:184:TOC; *see also Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-term Shareholder Engagement*, EUR-LEX (May 5, 2017), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828.

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[36] *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, *supra* note 1, at 1.
[37] *See*, *e.g.*, *C*ommission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, 17 C.F.R. pt. 241 (2019); *see also* Concept Release on the U.S. Proxy System, 75 Fed. Reg. 140, 42982 (July 22, 2010) (to be codified at 17 C.F.R. pt. 240, 270, 274, 275).
[38] 15 U.S.C. § 80b–2(a)(11).
[39] See *id*.

Appendix A
Summary of Recommended Changes to the Proposal

<u>Part I: §240.14a-1.</u>

§240.14a-1 Definitions.

* * * * *

(l) Solicitation. (1) * * *

(iii) The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy, including:

(A) Any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice, ~~separately from other forms of investment advice, and sells such proxy voting advice~~ for a fee, separately from other forms of advice.

(B) [Reserved]

(2) * * *

(v) the furnishing of any proxy voting advice by a person who furnishes such advice only in response to an unprompted request.

<u>Part II: §240.14a-2.</u>

§240.14a-2 Solicitations to which §240.14a-3 to §240.14a-15 apply.

* * * * *

(b) * * *

(1) Except as provided in paragraph (b)(9) of this section, any solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization. Provided, however, That the exemption set forth in this paragraph shall not apply to * * *

* * * * *

(3) Except as provided in paragraph (b)(9) of this section, the furnishing of proxy voting advice by any person (the "advisor") to any other person with whom the advisor has a business relationship, if: * * *

* * * * *

(9) Paragraphs (b)(1) and (b)(3) of this section shall not be available to a person furnishing proxy voting advice covered by §240.14a-1(l)(1)(iii)(A) ("proxy voting advice business") unless all of the conditions in the following paragraphs (i), (ii), and (iii) are satisfied:

(i) The proxy voting advice business includes in its proxy voting advice and in any electronic medium used to deliver the proxy voting advice prominent disclosure of:

(A) Any material interests, direct or indirect, of the proxy voting advice business (or its affiliates) in the matter or parties concerning which it is providing the advice;

(B) Any material transaction or relationship between the proxy voting advice business (or its affiliates) and the registrant, another soliciting person, shareholder proponent, or affiliates of any of the foregoing (as determined using publicly available information) connected with the matter covered by the proxy voting advice;

(C) Any other information regarding the interest, transaction, or relationship of the proxy voting advice business (or its affiliates) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship; and

(D) Any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship.

(ii) The proxy voting advice business provides the registrant or any other person conducting a solicitation (other than a solicitation exempt under §240.14a-2) covered by its proxy voting advice, prior to the distribution of that advice to its clients:

(A)(*1*) A copy of such proxy voting advice that the proxy voting advice business intends to deliver to its clients for a review and feedback period of no less than five business days, if the registrant or other soliciting person has filed its definitive proxy statement at least 45 calendar days before the security holder meeting date, or if no meeting is held, at least 45 calendar days before the date the votes, consents or authorizations may be used to effect the proposed action; or

(*2*) A copy of such proxy voting advice that the proxy voting advice business intends to deliver to its clients for a review and feedback period of no less than three business days, if the registrant or other soliciting person has filed its definitive proxy statement less than 45 calendar days, but at least 25 calendar days, before the security holder meeting date, or if no meeting is held, less than 45 calendar days, but at least 25 calendar days, before the date the votes, consents or authorizations may be used to effect the proposed action; and

(B) Solely with respect to a person that provided written feedback in response to the process described in paragraph (A)(1) or (A)(2), no earlier than the expiration of the period described in paragraph (A)(1) or (A)(2) of this section, as applicable, and no later than two business days prior to delivery of the proxy voting advice to its clients, a final notice of voting advice which must include a copy of such proxy voting advice that the proxy voting advice business will deliver to its clients, including any revisions to such advice made by the proxy voting advice business after the review and feedback period provided pursuant to paragraph (A)(1) or (A)(2) of this section, as applicable.

Note 1 to paragraph (b)(9)(ii): Once the two business day period specified in paragraph (B) of this section has expired, the proxy voting advice business will be under no further obligation to provide the registrant or any other soliciting person with additional opportunities to review its proxy voting advice with respect to the same meeting.

Note 2 to paragraph (b)(9)(ii): A proxy voting advice business may require the registrant or other soliciting person, as applicable, to enter into an agreement to maintain the confidentiality of any materials it receives pursuant to paragraph (b)(9)(ii) of this section and refrain from publicly commenting on those materials, provided that the terms of such confidentiality agreement:

(A) Shall be no more restrictive than similar types of confidentiality agreements the proxy voting advice business requires of the recipients of the proxy voting advice; and

(B) Shall cease to apply once the proxy voting advice business provides its advice to one or more recipients. The proxy voting advice business is not required to comply with paragraph (b)(9)(ii) of this section if the registrant or other soliciting person does not enter into such an agreement.

(iii) If requested by the registrant or any other person conducting a solicitation (other than a solicitation exempt under §240.14a-2) prior to expiration of the period described in paragraph (b)(9)(ii) of this section, the proxy voting advice business shall include in its proxy voting advice and in any electronic medium used to deliver the proxy voting advice an active hyperlink or any other analogous electronic medium that leads to the registrant's or other soliciting person's, as applicable, statement regarding the proxy voting advice.

Note to paragraphs (b)(9)(ii) and (b)(9)(iii): A proxy voting advice business will be under no obligation to comply with the provisions of paragraphs (b)(9)(ii) and (b)(9)(iii) of this section if the registrant or other soliciting person has not filed its definitive proxy statement at least 25 calendar days before the security holder meeting date (or if no meeting is held, at least 25 calendar days before the date the votes, consents or authorizations may be used to effect the proposed action).

(iv) An immaterial or unintentional failure of a proxy voting advice business to comply with one or more conditions of §240.14a-2(b)(9) will not result in the loss of such proxy voting advice business's ability to rely on the exemptions in paragraphs (b)(1) and (b)(3) of this section, so long as:

(A) The proxy voting advice business made a good faith and reasonable effort to comply; and

(B) To the extent that it is feasible to do so, the proxy voting advice business uses reasonable efforts to substantially comply with the condition as soon as practicable after it becomes aware of its noncompliance.

(v) A proxy voting advice business shall not incur liability under the antifraud provisions of the federal proxy rules set forth in § 240.14a-9 of this chapter for proxy voting advice that reflects the good faith and reasonable opinion of the proxy voting advice business at the time such proxy voting advice was delivered.

Part III: Adopting Release.

We also recommend that the Commission include the following paragraph in the adopting release of the Proposed Amendments or in other interpretive guidance:

"Where a proxy advisory firm (i) markets its expertise as a provider of proxy voting advice for a fee, and (ii) engages (directly or through other entities controlling, controlled by, or under common control with the proxy advisory firm) in one or more other forms of business that are marketed as distinct services and for which a distinct fee is earned (each an "**Other Business**"); a communication made by an Other Business would not be considered a solicitation unless the communication made by the Other Business would satisfy the definition of a solicitation absent the affiliation with the proxy advisory firm. For the avoidance of doubt, where a person that does *not* market its expertise as a provider of proxy voting advice for a fee makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited in connection with, such recommendation will not be considered a solicitation. These exclusions do not apply to a person that seeks to circumvent the requirements of Section 14 and the rules thereunder by engaging in a business the primary purpose of which is to provide research and recommendations to security holders as to their vote, consent, or authorization on specific matters for which security holder approval is solicited, for a fee."