Council of Institutional Investors®
The voice of corporate governance

Via E-Mail

November 8, 2018

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

Re: File Number 4-725 Roundtable on the Proxy Process
File Number S7-24-16 (Universal Proxy)

Dear Mr. Secretary:

I am writing in response to the Securities and Exchange Commission's (SEC or Commission) solicitation of comments on the proxy process and related SEC rules in connection with the announced staff roundtable on November 15, 2018 (Roundtable).[1]

The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $25 trillion in assets under management.[2]

We appreciate the opportunity to provide our views in response to the Commission's solicitation of comment on various aspects of the proxy process and rules. We thank you for your invitation to our Executive Director to participate at the Roundtable.

We generally support the Commission's review of this complex system and believe that it is particularly timely given changes in technology that have occurred in recent years. We offer the following views in response to the three areas of focus identified in the Roundtable press release: proxy voting mechanics, shareholder proposals and proxy advisory services.

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[1] Press Release, Securities and Exchange Commission, "SEC Staff to Host Nov. 15 Roundtable on the Proxy Process" (Sept. 21, 2018).
[2] For more information about the Council of Institutional Investors ("CII"), including its members, please visit CII's website at http://www.cii.org/members. We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), are non-voting associate members of CII, paying an aggregate of $24,000 in annual dues—less than 1% of CII's membership revenues. In addition, CII is a client of ISS, paying approximately $19,600 annually to ISS for its proxy research.

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I. Proxy Voting Mechanics and Technology

We believe that proxy voting infrastructure is, without question, the most important topic under consideration at this Roundtable. In our view, the SEC should both (1) consider fundamental longer-term improvement in proxy infrastructure, and (2) provide certain key short-term fixes in the current system.

Shareholder voting at corporate annual and special meetings is a core and essential element of corporate governance. Exercise of shareholder voting rights, including in the election of directors, underpins the legitimacy of public company governance.[3] Therefore, equity investors have a keen interest in a reliable, transparent and cost-effective system for voting proxies.[4]

The current system of proxy voting is built around old technological conceptions, and what have been called "nested layers of intermediation" or a "daisy-chained system of share ownership" prone to breakdown.[5] The system is fraught with inefficiencies and carries a too-large margin for error.[6] New technologies appear to offer the promise for a more stable, more reliable, less complex

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[3] See George S. Geis, "Traceable Shares and Corporate Law," *Northwestern University Law Review*, Vol 113, No. 2, 2018, ("A healthy system of shareholder voting is crucial for any regime of corporate law. The proper allocation of governance power is subject to debate, of course, but the fitness of the underlying mechanism used to stuff the ballot boxes should concern everyone. Proponents of shareholder power, for instance, cannot argue for greater control if the legitimacy of the resulting tallies is suspect. And those who advocate for board deference do so on the bedrock of authority that reliable shareholder elections supposedly confer.")

[4] Ken Bertsch, Executive Director, Council of Institutional Investors, Remarks to the SEC Investor Advisory Committee (Sept. 13, 2018).

[5] See Geis and Delaware Vice Chancellor J. Travis Laster, "The Block Chain Plunger: Using Technology to Clean Up Proxy Plumbing and Take Back the Vote," speech to CII, Sept. 29, 2016.

[6] Problems in the current system are well described by:

- Laster ("the current system works poorly and harms shareholders;" "the voting and stockholder infrastructure is complicated. The costs of that complexity fall on stockholders. One type of cost is uncertainty as to voting outcomes, which management uses to its advantage. Another type of cost is financial. Stockholders pay for the system. The folks who run the system are not affected by the election results and are generating profits in a non-competitive environment.")
- David Yermack, "Corporate Governance and Blockchains," *Review of Finance*, 2017, 7-31, ("the archaic corporate proxy voting system…has endured for hundreds of years with surprisingly few concessions to modern technology;" "the imprecision of vote tabulation under currently used procedures implies a high degree of inaccuracy in the outcome of close corporate elections.")
- Geis ("the underlying problems are systemic, not episodic. Our stock clearing system is a kludge;" "[T]he financial services industry seems to have cobbled together a functioning settlement and clearing system that is a stark improvement over paper-based trading. But corporate law has paid a price from the resulting complexity. The mechanisms for managing and tallying shareholder votes encompass layers of intermediaries that do not inspire confidence in accurate outcomes.")
- Marcel Kahan and Edward Rock, "The Hanging Chads of Corporate Voting," *The Georgetown Law Journal*, Vol. 96, 2008, (the "incredibly complicated system of U.S. corporate voting" is "noisy, imprecise, and disturbingly opaque," "far more complex and fragile than the one anticipated by the Delaware legal structure," and "an accident waiting to happen;" "no one designing a system today from the ground up would (or, in fact, does) adopt this structure.") Kahan and Rock quote prominent Delaware attorney Gilchrist Sparks III as estimating that in a contest closer than 55% to 45%, "there is no verifiable answer to the question 'who won?'". [CII comment: Mr. Sparks' remark from at least 10 years ago may overstate the range of uncertainty, but as an example of the continuing problem, we clearly do not know the actual winner of a 2017 proxy contest at Procter & Gamble.]

system that reduces the need for many compromises that we have grown inured to since the United States adopted a policy of "share immobilization" five decades ago.

Fundamental change, however, will take study and time, and potentially challenge entrenched interests. Therefore, we believe it is also important for the SEC to make some relatively easy near-term reforms that would improve proxy mechanics in the current system. [7]

Time to Look Seriously at Systemic Change

The current system, created in the wake of the Wall Street paper crisis of the late 1960s, is based on the idea of "immobilized" "fungible" shares.[8] We believe that technological change creates the potential to construct a better system of share ownership and clearing that is based on traceable shares. As George S. Geis, professor of law at the University of Virginia School of Law wrote earlier this year, "The rise of distributed ledgers and blockchain technology is poised to allow for specific share identification and precise records of share provenance."[9]

As CII's asset owner members originally affirmed in a 2010 policy statement, investors seek a proxy voting system that is timely, accurate, transparent (including through routine end-to-end vote confirmation) and efficient.[10] At CII's general membership meeting last month, our members updated this policy statement urging best use of technology to improve the proxy voting process.[11] The enhanced policy suggests that our members believe it is time to look seriously at the use of

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[7] Sometimes in the past, capital market participants have portrayed this as a choice between undertaking fundamental proxy infrastructure reform and incrementally changing the current system. CII itself has suggested that such an "either/or" choice. In 2010, CII published a white paper, "The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareowner Communications and Voting," prepared by Alan L. Beller and Janet L. Fisher, partners at Cleary Gottlieb Steen & Hamilton. The paper, with a narrower focus than the comments in this letter, favored an approach of incremental improvement over ambitious, systemic change. We believe the current moment is different – that technological innovation makes it worthwhile now to consider fundamental reform, even while we make continued efforts at short-term improvements to the present system.

[8] See Laster ("Under Congressional direction, the SEC responded by implementing a national policy of 'share immobilization'. To end the physical movement of securities, banks and brokers would place into depositories 'jumbo certificates' representing tens or hundreds of thousands of shares. These jumbo certificates would be issued in the name of the depository. This was a top-down, governmental solution, and it used 1970s era technology – the freezing of shares…. DTC [the Depository Trust Company, owned by banks and brokerage firms] holds the shares of its custodians in fungible bulk, meaning that it does not subdivide its shares into the separate accounts of the custodians' customers…. The federal solution of share immobilization was like Alexander cutting the Gordian Knot. It solved the immediate problem, but it created a lot of loose ends. One of those ends was state corporate law. Delaware corporate law is not built to accommodate the nominee system. It assumes that stockholders own shares directly and treats any deviation from direct ownership as a voluntary choice by the stockholder, but it isn't.")

[9] See Geis. See also, Anne Lafarre and Christoph Van der Elst, "Blockchain Technology for Corporate Governance and Shareholder Activism," European Corporate Governance Institute Working Paper Series in Law, March 2018; and CSD Working Group on DLT, "General Meeting Proxy Voting on Distributed Ledger, Product Requirements v. 2.1."

[10] CII, Statement on Principles for an Effective and Efficient Proxy Voting System (adopted Apr. 13, 2010) (on file with CII).

[11] CII, "Effective and Efficient Proxy Voting" (updated Oct. 24, 2018) ("Technology should be used to improve the proxy voting process, including through the adoption of private blockchains operated by trusted third parties that promote each of the above five objectives [timeliness, accessibility, accuracy, certainty and cost-effectiveness] while safeguarding the identities, holdings and voting decisions of individual shareholders.")

distributed ledger technology, system-wide, to promote the goals articulated earlier, while safeguarding the identities, holdings and vote decisions of individual shareholders.

We believe that a reconceptualization of the system should look first to key principles, and remain open to various alternatives, including a central-ledger book-entry system as described by Marcel Kahan and Edward Rock of New York University in their landmark 2008 paper.[12] As discussed below, however, our sense now is that an approach based on a private, permissioned blockchain – controlled by a central gatekeeper – may prove to be the best approach, and should receive substantial attention.

We believe reform should be based on the following principles:

- **Maximizing accuracy and reliability**, with the understanding that beneficial owners (not intermediaries like brokers and banks) are the shareholders whose voting intent is critical to the legitimacy of the system.
    - For example, the current system continues to permit overvoting, which normally is examined only when a broker or bank seeks to cast more than 100% of its allotment of shares. In our understanding, brokers and banks appear to disregard inaccuracies in vote counts at the beneficial owner level, as long as the total vote cast by a given broker or bank is less than 100% of their total Depositary Trust Corporation position. In this and some other aspects of the system, brokers and banks seem to act as if the vote belongs to them, rather than the beneficial owners. True "ownership" of the vote needs to be with the beneficial owner, who actually owns the stock, and has the interest in maximizing shareholder value.

- **Minimizing compromises** that cloud the validity of voting
    - For example, the early record date system is vital to making the current system work, but gives rise to substantial anomalies and disconnects between voting rights and ownership. At best, there can be significant variation in shares owned by particular shareholders on the meeting date compared to the record date. At worst, the time lag provides opportunities for gamesmanship and certain forms of empty voting.

- **Carefully considering the perceived need for confidentiality** of share positions.
    - A distributed ledger solution might do away with the NOBO/OBO system that is an important factor in the current system's complexity, but we believe this solution can be structured in a way that preserves confidentiality of share positions.

- **Establishing and maintaining an even playing field** on contested matters between a company and dissidents.

- **Clarifying what proxy infrastructure functions lend themselves to natural monopoly**, and what elements are better suited for competitive markets, with appropriate oversight.

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[12] Kahan and Rock.

  - The SEC should develop effective regulation of utility functions that are natural monopolies and act to ensure competition in other areas.

- **Achieving cost-effectiveness in the long-term**.
  - Exploration of systemic change is likely to be time-consuming and require resources, but it offers the potential for reduced cost, and much greater reliability, long-term.

We do not wish to be overly prescriptive at this stage on how a new system should look, and we believe the SEC should explore multiple alternatives. That said, we would prioritize the exploration of distributed ledger technology based-voting involving the following components:

1. **Construction of the Blockchain:** An intermediary, acting as a gatekeeper, creates a blockchain for the company and its shareholders. This blockchain would be permissioned, meaning only the trusted gatekeeper can enter its content. Neither the company nor other shareholders would be able to see the identities or holdings of any individual shareholder. The blockchain would record each of the company's beneficial owners and their holdings as of a predetermined record date, ideally much closer to the meeting than allowed presently (and ideally closer even than the minimum currently allowed under Delaware law of 10 days). This determines each shareholder's entitlements, for example their voting rights, right to view proxy materials, or right to submit a shareholder proposal subject to ownership thresholds.

2. **Dissemination of Proxy Materials:** As a meeting of shareholders approaches, the gatekeeper can upload the company's proxy materials on the blockchain for shareholders to view. Due to the nature of the blockchain, once information is entered, it cannot be changed or removed—only added. This promotes transparent, far less expensive record-keeping and ensures that all eligible shareholders can access the materials instantaneously and simultaneously.

3. **Vote Allocation and Authentication:** Based on shareholders' equity holdings as of the predetermined record date before a meeting, the gatekeeper allocates votes subject to the company's capital structure and voting rights. Shareholders will know precisely how many votes they control before casting them. Before the meeting, whoever plans to execute the votes—which could be an individual shareholder or a designated proxy—must authenticate his or her identity with the gatekeeper outside of the blockchain (e.g. by presenting legal identification). The gatekeeper will record proof of authentication in the blockchain and create a digital ID for each shareholder or proxy, akin to login credentials.

4. **Vote Execution and Tabulation:** During a predetermined voting period, shareholders or their proxies will execute their instructions over the blockchain, casting their allotted votes in each proposal. The blockchain will relay the voting instructions and verification that the votes are counted back to each shareholder, providing immediate and accurate end-to-end confirmation.[13] Neither the company nor other shareholders will be able to see how any

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[13] *See, e.g.*, Letter from Jonathan Grabel, Chief Investment Officer, Los Angeles County Employees Retirement Association to Mr. Brent Fields, Secretary, Securities and Exchange Commission 2 (Oct. 30, 2018) ("New technologies may present opportunities for cost-effective methods to better facilitate stakeholder collaboration and vote confirmation).

> individual shareholder voted. Tabulation would occur in real time. Once the voting period ends, the blockchain can immediately report the aggregate results to the company and its shareholders simultaneously. Again, due to the nature of the blockchain, once votes are entered, they cannot be removed or altered, ensuring that the final tally reflects a certain and complete result of the vote.[14]

If deployed properly, distributed ledger technology-based proxy voting could protect investor privacy while enhancing:

- Timeliness—The dissemination of materials, process of voting, and reporting of results occurs immediately and simultaneously when conducted on the blockchain.

- Accessibility— The blockchain represents a technological advancement that improves the accessibility of the proxy voting process to all shareholders, large and small, potentially improving participation rates.

- Accuracy— The blockchain utilizes a gatekeeper to allocate and authenticate votes, and the technology itself immutably tabulates votes as they are cast.

- Certainty— Shareholders can achieve end-to-end confirmation on the blockchain since it records the executed voting instructions.

- Cost-effectiveness—The blockchain-based system in the long run can substantially reduce costs associated with the current system by eliminating certain delays, frictions and opacities.[15]

While this Roundtable is focused on the proxy process, a system of traceable shares actually addresses broader matters of share custody and transfer. We believe traceable shares could substantially improve areas of corporation law that require share identification, including Section 11 claims and appraisal rights.[16] In theory, Delaware could fix the clear misconception in Delaware law that direct ownership is a voluntary choice under the current system. But in our view, it makes more sense to fix this important federal/state disconnect at the federal level, given the clumsiness of immobilized shares and technology that enables a better alternative.

The prospect of systemic change will likely encounter opposition from interests that benefit from inefficiencies endemic to the current arcane system, which is to be expected. In addition, we suspect that various parties worried about a "slippery slope" toward one or another feared outcome also may try to kill reform at the starting gate. CII understands the attraction of a "just-say-no" approach. For example, we have members highly concerned about the privacy of their holdings, and opening up the possibility of systemic change will raise questions on moving beyond the

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[14] Bertsch remarks at 3.
[15] CII, Effective and Efficient Proxy Voting.
[16] See Geis (on Section 11 claims and arbitration) and Laster (on arbitration) for excellent discussions of these issues.

OBO/NOBO system that could endanger, from this perspective, the confidentiality of positions. We believe it is possible to construct a system of traceable shares that retains the same level of confidentiality as today, however, and would not want a consideration of fundamental reform to stall based on the fear that a new door has opened that in theory could diminish confidentiality. Another example: we believe that proponents of "tenure voting" (that is, voting rights that are greater the longer the ownership period) must see reform of the current system for tenure voting to be practicable. We strongly oppose tenure voting. However, we think that debate should focus on the wisdom of unequal voting rights – and we should not rely on defending an archaic system to prevent the possibility of advocates of tenure voting winning the argument on the merits.

Near Term Improvements

As indicated, systemic change to the proxy voting process will require substantial focus, resources and time. In light of this, it is important also to improve functionality of the current system.

We respectfully request the SEC to consider taking the following two steps in the near-term. It also may be useful to consider taking certain other action items contemplated in the SEC's 2010 "Concept Release on the U.S. Proxy System." For example, we suspect it would be of value to require "pre-reconciliation" and other best practices in account reconciliation used by broker-dealers to address "imbalances" from differing recorded share positions, which often relates to share lending. The goal should be to minimize broker-dealer interventions to "allocate" votes of beneficial owners.

1. Adopt a Final Rule on Universal Proxy

CII and many or our member funds[17] believe the SEC should promptly adopt the final rule largely consistent with the 2016 SEC proposal on Universal Proxy (2016 Proposal),[18] and fix a major long-standing problem that affects the most consequential and contested proxy votes.[19]

Under the existing bona fide nominee rule,[20] one party in a proxy contest may not include the other party's nominees for corporate director on its proxy card unless the other party's nominees consent.[21] For a variety of reasons, consent is rarely granted.[22] As a result, shareowners usually have no practical ability through proxy voting to "split their ticket" and vote for the combination of dissident and management nominees that they believe best serve their economic interests.[23]

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[17] *See, e.g.*, Letter from Jonathan Grabel at 2 ("LACERA recommends that the Commission take action on proposed amendments to federal proxy rules to require use of universal proxy ballots in contested elections").
[18] Universal Proxy, Exchange Act Release No. 79,164, Investment Company Act Release No. 32,339, 81 Fed. Reg. 79,122 (proposed rule Oct. 2016).
[19] *See, e.g.*, Tom Buerkle, "Proxy Plumbing Is Bigger Problem Than Adviser", Reuters, Oct. 2, 2018 ("Regulator's would do better to focus on creaky proxy mechanics, starting with the ballot.").
[20] Requirements as to Proxy, 17 CFR 240.14a–4(d)(1) (2010).
[21] *See* 81 Fed. Reg. at 79,124.
[22] *Id.* (describing the reasons why consent is "rarely provided").
[23] *See id.* at 79,160.

Investors frequently have an interest in splitting their tickets, and there is no good reason they should be required to attend meetings to do so. A shareholder voting by proxy should have the same voting options as a shareholder who votes in person.

We believe adopting a final rule generally consistent with the 2016 Proposal would reduce confusion among both institutional and individual investors that results from current multiple and incomplete ballots.

CII submitted extensive comments in response to the 2016 Proposal (Comment Letter).[24] We have provided additional comments on several occasions since then, most recently in our July 19, 2018, letter on the SEC's 2018-2022 Strategic Plan.[25]

Since the issuance of CII's Comment Letter, SEC Chairman Jay Clayton and SEC Director of Division of Corporation William Hinman shared with CII staff a few legitimate concerns about some issues raised by the 2016 Proposal, but we believe those issues are easily addressed. More recently, it was reported that Starboard Value CEO Jeffrey Smith raised a concern about the 2016 Proposal.[26] As described below, it is our understanding that Mr. Smith's concern is fundamentally at odds with the purpose of a universal proxy.

Chairman Clayton' Concerns

The two issues raised by Chairman Clayton at CII's 2018 spring conference were: (1) the solicitation threshold that would trigger requirement of a universal proxy; and (2) the circumstance when the election of a dissident results in an incumbent board member refusing to serve.[27]

On the first issue, the 2016 Proposal would require that a dissident solicit at least a majority of shares for the universal proxy rule to kick in.[28] CII agreed with that threshold, but in light of the Chairman's concern, we would support moving to a higher threshold in the final rule that would (1) increase minimum solicitation requirement to 75%; and (2) require that total number of persons solicited exceeds 10.[29]

On the second issue, we suggest, consistent with our response in the Comment Letter,[30] that the final rule require a registrant to disclose in its proxy statement: (1) if a party's nominees will not

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[24] Letter from Ken Bertsch, Executive Director, Council of Institutional Investors, to Brent J. Fields, Secretary, Securities and Exchange Commission 3 (Dec. 28, 2017) ("With minor enhancements, the proposed framework will provide for a constructive universal proxy regime that gives greater effect to existing shareholder rights.").
[25] *See, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Nicole Puccio, Branch Chief, Securities and Exchange Commission 3-12 (July 19, 2018).
[26] ActivistInsight, Business, "Starboard CEO Jeff Smith's Stand to Fix Universal Ballot Contests," WV, Oct. 2018.
[27] *See, e.g.,* Letter from Jeffrey P. Mahoney at 8.
[28] *See* 81 Fed. Reg. at 79,175.
[29] *See, e.g.,* Letter from Jeffrey P. Mahoney at 10.
[30] Letter from Ken Bertsch at 8 ("We believe it would be beneficial to adopt an amendment requiring disclosure if a party's nominees "will not" serve if elected with any of the opposing party's nominees. . . . Disclosure describing how the resulting vacancy will be filled under the registrant's governing documents and applicable state law should also be required in order to fully equip shareholders with the information required to make an informed decision.")

serve if elected with any of the opposing party's nominees; and (2) how the resulting vacancy will be filled under the registrant's governing documents and applicable state law.[31] Such disclosure would ensure that shareowners have full information before casting their votes and that companies will undergo smooth transitions following proxy contests.

Director Hinman's Concern

Director Hinman indicated to CII staff at a September 24, 2018, meeting that he is concerned about the proposed penalty if a dissident fails to fulfill the minimum solicitation and related requirements provided for in the 2016 Proposal.

In response to Director Hinman's concern, we suggested, consistent with our response in the Comment Letter,[32] that the final rule provide that such conduct by the dissident be considered a violation of the proxy rules, with the same consequences as other such violations, and that the dissident be required to compensate the registrant for expenses incurred in connection with the dissident's actions.[33]

Mr. Smith's Concern

Jeffrey Smith, the Managing Member, CEO and CIO of Starboard Value, L.P. an activist investor, raised a concern at Schulte Roth & Zabel's October 2018 shareholder activism conference. Mr. Smith noted that under the 2016 Proposal, every single board nominee in a proxy contest involving a dissident short slate could receive more than 50% of the vote, with none of the dissidents seated.[34] In Mr. Smith's hypothetical example, there are eight director seats up for election, a full slate of eight management candidates, and a short slate of five dissident candidates.[35] Mr. Smith illustrates that it is possible that the five dissident candidates could each receive 51% of the vote and each of the eight management candidates could receive more than 51% of the votes.[36] Mr. Smith's proposed solution is to "divide the universal ballot into two sections – one featuring an equal number of candidates for contested elections, and the other containing the uncontested nominees."[37]

In response, we note that under a plurality voting standard, which is the appropriate standard in a contested election according to CII's member-approved policies, the nominees who receive the

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[31] Letter from Jeffrey P. Mahoney at 11-12.
[32] Letter from Ken Bertsch at 32 ("Such conduct should be considered a violation of the proxy rules, with the same consequences as other such violations . . . [and] [i]n addition, the dissident could be required to compensate the registrant for its expenses incurred in connection with the dissident's actions.").
[33] Email from Jeff Mahoney, General Counsel, Council of Institutional Investors to Julie Z. Davis, Senior Special Counsel to the Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, (Attachment Sept. 28, 2018) (on file with CII).
[34] ActivistInsight at 3 (Describing the issue as "[i]n a fight involving a short slate against a full one, there are enough possible outcomes for every single candidate to receive over 50% of the shares.").
[35] *See id.* (see link to "SRSStarBoardSides.pdf" at 1).
[36] *See id.* (see link to "SRSStarBoardSides.pdf" at 5).
[37] *Id.* (see link to "SRSStarBoardSides.pdf" at 6).

most "for" votes are elected to the board until all board seats are filled.[38] Therefore, we believe the outcome Mr. Smith describes is the appropriate one given the stated facts.

Mr. Smith's proposed solution is excessively complex, in our view, and his approach would appear to limit the degree of choice afforded to shareholders from a universal proxy and systematically increase the likelihood of success for the dissident's slate.[39] For these reasons, we believe the Commission should reject Mr. Smith's proposed solution.[40] We believe that it is the dissident's responsibility to communicate to other shareholders why its nominees are superior to incumbent nominees, and to persuade investors to withhold support from particular incumbent nominees so as to gain plurality voting support for their short slate, should a dissident decide to take a short slate approach.

2. Provide Guidance to Assure Vote Confirmation

Between the complexity of intermediary chains and challenges around fungible shares, many of our members continue to lack confidence that their shares are always fully and accurately voted. Institutional investors generally vote on electronic platforms and should routinely and promptly see vote confirmations of how (and how many) shares in each account were voted on each voting item.

Since 2010, market intermediaries have worked on a system to provide vote confirmation on request. Broadridge and various transfer agents appear to have developed a protocol to provide vote confirmation in most cases. Broadridge itself offers transfer agent services, but no other transfer agents appear to be cooperating on vote confirmation. We believe the SEC should mandate that all intermediaries transmit the necessary information to enable vote confirmation for all votes.[41]

To be clear, we are not convinced that the protocol worked out by Broadridge and transfer agents will provide complete assurance to investors in all cases. But if a protocol along the lines that Broadridge worked on for years with transfer agents is implemented widely, we believe there would be significantly more awareness of specific problems in voting, and confidence in votes being cast fully and accurately where that is the case.

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[38] *Id.*

[39] ActivistInsight at 3 (Commenting that "[o]ne objection [to Mr. Smith's proposed solution] might be that it would limit the degree of choice afforded by the universal ballot - perhaps its chief appeal").

[40] Letter from Ken Bertsch at 3 ("We did not propose a universal proxy card because we thought it would increase the likelihood of success for a dissident, and we do not believe it will, . . . [w]e proposed a universal proxy card to facilitate shareholder voting rights.").

[41] *See* Letter from Jonathan Grabel at 2 ("LACERA recommends that the Commission assess options to efficiently facilitate end-to-end vote conformation"); Letter from Carine Smith Ibenacho, Chief Corporate Governance Officer, and Severine Neervoort, Senior Analyst, Policy Development, Norges Bank Investment Management, to Securities and Exchange Commission 1-2 (Nov. 11, 2018) ("we respectfully submit that introducing a mandatory requirement for all intermediaries to transmit the necessary information throughout the voting chain, to provide transparency to shareholders on how their votes have been cast, would help address this issue").

II. Shareholder Proposals and Effective Shareholder Engagement

CII and its members have a deep interest in ensuring that Rule 14a-8,[42] the federal rule that governs shareholder proposals, is a fair and workable standard for shareowners and companies.[43] The rule provides an orderly means to mediate differences between managers and owners.

Shareholders can actively engage with company boards and management along a spectrum, from letter writing and meetings, to shareholder proposals, to full-scale proxy fights or legal action. Shareholder proposals permit investors to express their voice collectively on issues of concern to them, without the cost and disruption of waging proxy fights. One-on-one engagement is not a substitute for collective expression of views permitted by shareholder proposal, and proxy fights are simply inappropriate for pursuing many issues of concern to various shareholders.

We are mindful that many improvements in U.S. corporate governance practices would not have occurred without a robust shareowner proposal process in place.[44] For example:

- Shareholder proposals gave impetus to behind the practice—now largely mandated by major U.S. stock exchanges' listing standards—that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance. Similarly, investors pressed for independent board leadership, now prevalent at U.S. companies through independent lead directors or independent chairs, primarily through shareholder proposals in the 1990s.[45]

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[42] 17 CFR 240.14a-8 (Sept. 16, 2010).
[43] *See* "Examining the U.S. Proxy Voting System: Is it Working for Everyone," Corporate Governance Roundtable, hosted by Rep. Scott Garrett, 114th Cong (Nov. 16, 2015) (Statement of Amy Borrus, Interim Executive Director, Council of Institutional Investors at 7). *See generally* "Joint Statement on Defending Fundamental Shareowner Rights" (June 2, 2017) (commenting that "**ability of shareowners to file shareholder proposals is a fundamental investor right first established by the federal government in 1942 for reasons that remain vital today**," and signed by Comptrollers, Controllers, and/or Treasurers of the City of New York, and states of California, Connecticut, Illinois, Massachusetts, Oregon, Pennsylvania and Rhode Island).
[44] *See* Letter from Jonathan Grabel at 3 ("many governance practices now considered standard practice have emerged from shareholder resolutions and spread across the market, absent market regulation or legislation"); letter from Thomas P. DiNapoli, State Comptroller, State of New York, Office of the State Comptroller, to the Honorable Jeb Hensarling, Chairman, Committee on Financial Services, United States House of Representatives 1 (Apr. 26, 2017) ("It has been my experience over the past 10 years as Comptroller that shareholder resolutions are an effective means to voice concerns and propose changes in order to protect Fund investments and encourage sustainable, robust corporate practices at our portfolio companies."); Statement of New York City Comptroller Scott M. Stringer on the April 19th Discussion Draft of the Financial CHOICE Act of 2017 (Act) 3 (Apr. 25, 2017) (describing some of the many achievements "made possible because of the NYC Pension Funds' long-standing right and ability to file shareholder proposals—a right and ability that would be pointlessly eviscerated by the passage of the Act").
[45] "Joint Statement on Defending Fundamental Shareowner Rights" at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Independent Directors*" shareowner proposals); Ceres et al., "The Business Case for the Current SEC Shareholder Proposal Process" at 6 (Apr. 2017); IRRC Corporate Governance Bulletin, "Independence of Directors Emerges as Major 1993 Issue," IRRC (Nov./Dec. 1992) (on file with CII).

- In 1987, an average of 16% of shares were voted in favor of shareholder proposals to declassify boards so that directors stand for election annually. In 2012, these proposals enjoyed an 81% average level of support. Ten years ago, less than 40% of S&P 500 companies held annual director elections compared to more than two-thirds of these companies today.[46]

- Electing directors in uncontested elections by a majority—rather than plurality—vote was considered a radical idea 15 years ago when advocated by shareholders through proposals filed with numerous companies. Today, 90% of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority voting proposals.[47]

- Proxy access proposals built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years. Resolutions filed by the New York City Comptroller and other pension funds to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, more than 400 public companies have adopted proxy access bylaws.[48]

Benefits to Companies

The cost to public companies of the existing shareholder proposal process is generally low and the process often results in benefits to companies.[49] It is important to note that most companies receive few, if any, shareholder proposals.[50]

The average Russell 3000 company can expect to receive a proposal every 7.7 years.[51] Proposals are typically filed with larger companies (i.e., S&P 500) that have the resources to address such shareholder input.[52]

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[46] "Joint Statement on Defending Fundamental Shareowner Rights" at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Annual Election of Directors*" shareholder proposals); Ceres et al. at 6.

[47] "Joint Statement on Defending Fundamental Shareowner Rights" at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Majority Voting for Election of Directors*" shareholder proposals); Ceres et al. at 6.

[48] "Joint Statement on Defending Fundamental Shareowner Rights" at 2 (commenting on advancements in U.S. corporate governance practices that has resulted from "*Shareowner Access to the Proxy*" shareholder proposals); Ceres et al. at 6.

[49] *See* Ceres et al. at 11-12 (providing an analysis of the potential range of company costs).

[50] According to the ISS Voting Analytics database of Russell 3000 companies on file with CII, shareholders submitted an average of 836 proposals at 386 companies per year between 2004 and 2017. The number of submitted proposals fluctuated between approximately 800-1000 proposals per year, except for a dip to 603 proposals in 2011 and 673 proposals in 2012 after the SEC's adoption of say-on-pay vote requirements. According to Gibson Dunn, "shareholders submitted 788 proposals during the 2018 proxy season, down 5% from 827 in 2017 and down 14% from 916 in 2016." Gibson Dunn, Shareholder Proposal Developments During the 2018 Proxy Season 3 (July 12, 2018).

[51] ISS Voting Analytics database (on file with CII).

[52] *See* Ceres et al. at 12 (discussion of frequency of shareholder proposals at public companies).

For companies that do receive a proposal, the median number of proposals is one per year.[53] When shareholders file proposals, companies often agree to act on the request made in the proposal. In this respect, an average of 37.5% of shareholder proposals broadly related to climate change during the 2012-2016 proxy seasons were withdrawn by filers in response to the company agreeing to the request in some manner.[54]

The withdrawal rates for several other topics are much higher.[55] This outcome suggests that many companies find benefits from committing to act on shareholder proposals prior to a vote.

Additionally, there are a number of bases upon which a company may rely to exclude shareholder proposals, including the provision of Rule 14a-8 that governs the resubmission of such proposals.[56] Pursuant to this provision, if the proposal addresses substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the prior five (5) calendar years, the company may exclude the proposal for any shareholder meeting held within three (3) calendar years of the last submission if the proposal received: less than (i) 3% of the vote on its first submission; (ii) 6% on the second; or (iii) 10% on the third and subsequent submissions.[57]

Some critics of Rule 14a-8 suggest that the current resubmission levels should be raised to reduce the number of proposals filed repeatedly for a number of years.[58] The data often referenced to support those claims is, at best, selective and without context.[59]

To a provide a basis for a more informed discussion on this topic, the Council of Institutional Investors Research and Education Fund has analyzed the more than 3,600 shareholder proposals that went to votes at Russell 3000 companies between 2011 and 2018. We are submitting the resulting report, entitled "Clearing the Bar: Shareholder Proposals and Resubmission Thresholds," with this letter.[60]

The shareholder proposal process has proven a key mechanism for effective shareholder engagement over half a century. Shareholder proposals should not be further restricted without first

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[53] *Id*.

[54] Data compiled by Ceres (on file with CII).

[55] *See* Ceres et al. at 11 ("The New York City Comptroller's Office withdrew 80 percent of the 45 proxy access resolutions it filed during the 2016 and 2017 proxy seasons due to commitments by 36 companies.").

[56] 17 CFR 240.14a-8(i)(12); *see* SEC SLB No. 14J, Shareholder Proposals (Oct. 23, 2018) (providing more guidance, including the further expansion of certain other exclusions provided under Rule 14a-8).

[57] 17 CFR 240.14a-8(i)(12)

[58] *See, e.g.,* Letter from Chris Natram, Vice President, Tax and Domestic Economic Policy, to Brent J. Fields, Securities and Exchange Commission 7 (Oct. 30, 2018) ("NAM urges the SEC to . . . implement increased resubmission thresholds").

[59] Id. (referencing data indicating that "nearly 30 percent of all proposals had been submitted three or more times" but failing to reference data regarding the percentage support for those proposals or the percentage of those proposals that obtain majority support or result in companies engaging with proponents to reach a mutually agreeable solution).

[60] Brandon Whitehill, "Clearing the Bar: Shareholder Proposals and Resubmission Thresholds," CII, November 2018.

conducting a thorough fact-based analysis that includes a consideration of the benefits of the current shareholder proposal rule to companies, investors and the capital markets generally. That analysis should also include an evaluation of how greater restrictions on shareholder proposals may lead investors to express their views through other means such as opposing director nominees.[61]

III. The Role and Regulation of Proxy Advisory Firms

Many CII members and other institutional investors voluntarily contract with proxy advisory firms to obtain cost-effective independent research to help inform their proxy voting and engagement decisions, and to execute votes based on funds' own proxy voting guidelines. The Commission has long recognized that proxy research firms "serve an important role in the shareholder voting process."[62]

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

The responsibility for appropriate use of proxy advisory firms rests with investors – the users of the research and services. In 2014, the SEC staff wisely issued guidance, in Staff Legal Bulletin No. 20 (SLB 20), reaffirming that investment advisors have an ongoing duty to maintain oversight of proxy research firms and other third-party voting agents.[63] Importantly, that duty includes:

> [A]scertain[ing], among other things, whether the proxy advisory firm has the *capacity and competency* to adequately analyze proxy issues. In this regard, investment advisers could consider, among other things: the adequacy and quality of the proxy advisory firm's staffing and personnel; the *robustness of its policies and procedures* regarding its ability to (i) *ensure that its proxy voting recommendations are based on current and accurate information* and (ii) *identify and address any conflicts of interest* and any other considerations that the investment adviser believes would be appropriate in considering the nature and quality of the services provided by the proxy advisory firm.[64]

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[61] *See, e.g.*, "ONPOINT/A Legal Update from Dechert's Corporate Governance Practice, Shareholder Proposal Reform under the Financial CHOICE Act of 2017: A Welcome Development for Companies or a Trojan Horse?" 2 (May 2017) ("If that outlet for complaints is removed, aggrieved shareholders may have no choice but to resort to more direct, blunt action, such as binding bylaw proposals, withhold vote for director campaigns, or even the ouster of company directors via proxy access or in a conventional contest.").
[62] *See, e.g.*, Commissioner Robert J. Jackson, Jr., "Statement on Shareholder Voting" at 1 (Sept. 14, 2018) (referring to Proxy Voting by Investment Advisers, Investment Adviser Act Release No. 2,106, 68 Fed. Reg. 6,585 (final rule Feb. 7, 2003)).
[63] SEC Staff Legal Bulletin No. 20 at 2-3 (June 30, 2014) (describing the investment adviser's ongoing duty to oversee a proxy advisory firm that it retains).
[64] *Id.at* 2-3 (emphasis added & footnotes omitted).

CII and many institutional investors publicly supported the 2014 guidance.[65] We are unaware of any compelling evidence indicating that the guidance is not being followed or that more regulation of proxy research firms is necessary or in the best interests of investors, companies, or the capital markets generally.[66]

Most large institutional investors are not "robo-voting" the proxy research firms' recommendations, just as most no longer automatically "robo-vote" in line with all management recommendations. Rather, most large institutions vote their proxies according to their own guidelines.[67] While many large institutional investors rely on proxy advisors to help them manage the analysis of myriad issues presented in the proxy statements accompanying thousands of shareholder meetings annually,[68] and to help administer proxy voting, these services do not constitute an abdication of responsibility for their own voting decisions.[69]

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy research firm, recommended voting against say-on-pay proposals at 12.3% of Russell 3000 companies through Nov. 1, 2018, only 1.4% of those proposals received less than majority support from shareowners.[70] Similarly and for the same period, although ISS recommended voting against or withholding votes from the election of 11.6% of uncontested director-nominees, just 0.2% failed to obtain majority support.[71]

More regulation of proxy research firms could increase costs for pension plans and other institutional investors, with no clear benefits. Higher regulatory costs risk reducing competition among an already limited number of proxy research firms in the U.S. market and impose new barriers for entry.[72] This would ill-serve asset managers and their ultimate beneficiaries, and would damage companies by weakening an important tool used by investors in exercising their

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[65] *See* Letter from Jeff Mahoney, General Counsel, CII to The Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services et al. 5 (July 23, 2014) ("Consistent with our recommendation, the Guidance clarifies that investment advisers are not required to vote every proxy.").

[66] *See, e.g.,* Jackson at 2 (Sept. 14, 2018) ("Rigorous review of the evidence shows . . no basis for . . . policy changes" regarding proxy research firms); *see generally*, Myth v. Fact, Protect the Voice of Shareholders (last visited Nov. 4, 2018) (ISS & CII website responding to myths raised by some critics of proxy research firms).

[67] *See, e.g.,* Letter from Jonathan Grabel ("LACERA votes proxies according to its *Corporate Governance Principles.*").

[68] *See, e.g.,* U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities, Capital Markets" at 31 (Oct. 2017) ("institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements").

[69] *See, e.g.,* Stephen J. Choi et al., "The Power of Proxy Advisors: Myth or Reality?", 59 Emory L.J. 869, 869 (2010) (distinguishing correlation from causality and concluding that the impact of Institutional Shareholder Services recommendations on shareholder votes is "substantially overstate[d]").

[70] ISS Voting Analytics Database (Nov. 2, 2018) (on file with CII).

[71] *Id.*

[72] Karen Barr, "Letter to Editor: Don't Disparage or Restrict Proxy Advisors," Wall St. J., Sept. 24, 2018 ("Given the utility of proxy advisory services, policy makers should refrain from measures that would restrict their use or make those services more expensive to advisers and their clients, or further raise barriers to entry for new proxy advisory firms.").

franchise, which is key to corporate accountability. We believe voting decisions will be worse, not better, if one or more proxy advisory firms are driven out of business, and new entrants fail to enter the market due to prohibitive regulatory costs.

The bottom line: excessive regulation of proxy research firms could impair the ability of institutional investors to promote good corporate governance and accountability at the companies in which they own stock. Proxy research firms, while imperfect, play an important and useful role in enabling effective and cost-efficient independent research, analysis and informed proxy voting advice for large institutional shareholders, particularly since many funds hold shares of thousands of companies in their investment portfolios.

The entities that are in the best position to make assessments about whether proxy research firms are adhering to contractual terms negotiated with clients are the clients themselves. Institutional investors that choose to purchase these services are sophisticated consumers who are fully capable of making prudent choices based on free-market principles. The consumers are generally not requesting more regulation of proxy research firms. Moreover, as SLB 20 makes clear, the SEC appropriately regulates reliance on proxy advisory firms through oversight of investment advisors. There is no need to pile on an additional regulatory regime.

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The urgent need is to fix proxy infrastructure, not to impose new regulatory burdens on proxy advisory firms. We are pleased that the Commission will examine proxy infrastructure issues in the November 15 Roundtable, but are distressed that the Commission proposes to spend equal time on considering new proxy advisory firm regulation – a solution in search of a problem.[73]

We would be more than happy to discuss any of these issues, and look forward to participating in the Roundtable. If you have any questions or need additional information, please contact Ken Bertsch or Jeff Mahoney at 202.822.0800 (ken@cii.org; jeff@cii.org).

Sincerely,

Kenneth A. Bertsch
Executive Director

Jeffrey P. Mahoney
General Counsel

Attachment

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[73] *See* Tom Buerkle, "Don't Shoot the Messenger", Reuters, Oct. 2, 2018 ("the SEC has options that would achieve much more than undermining proxy advisers"); s*ee also* Jackson at 2 ("I am worried that the Roundtable's consideration of contentious issues like this one [proxy advisory firms] will distract from the urgent need to fix the basic mechanics of modern corporate democracy.").