



Council of Institutional Investors®

The voice of corporate governance

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Leading Investor Group Dismayed by SEC Proxy Advice Rules

Washington, D.C., July 22, 2020—The Council of Institutional Investors (CII) is relieved that the Securities and Exchange Commission (SEC) has dropped the most problematic aspect of its original proposal for heavy-handed regulation of proxy advisory firms. Even so, we are concerned that the rules and guidance the SEC approved today could result in delays in distribution of proxy advice, driving up costs for investors, impairing the independence of proxy advice and causing uncertainty for institutional investors. Just how damaging the new regulatory regime could be isn't clear because the SEC has acted without providing details of its approach.

"We are disappointed that the commission did not first issue a revised proposal and draft guidance and seek public comment," said CII Executive Director Amy Borrus.

The SEC had proposed to require the firms to give companies two rounds of reviews of proxy advice before sending it to their investor clients. The final rule appears to eliminate this most damaging aspect of the SEC's initial proposal, which would have severely weakened important shareholder rights.

However, the new rules and guidance seem to effectively require investment advisors who vote proxies on behalf of investor clients to consider and evaluate any response from companies to proxy advice before submitting votes. That could cause significant delays in the already constricted proxy voting process. It also could jeopardize the independence of proxy advice as proxy advisory firms may feel pressure to tilt voting recommendations in favor of management more often, to avoid critical comments from companies that could draw out the voting process and expose the firms to costly threats of litigation.

"The SEC has not established a compelling case to tighten regulation of proxy advisory firms, and we are concerned that it has adopted untested and unvetted requirements that could have adverse effects on investors' ability to get the timely and unbiased proxy advice they need to act as stewards of the companies they own," Borrus said.

CII believes the legal basis for the SEC's rulemaking—its interpretation that proxy advice is "solicitation" under the federal securities laws—is fundamentally flawed. A leading proxy advisory firm, Institutional Shareholder Services (ISS), has filed a lawsuit on this point and we expect it ultimately will be decided in court. We believe the SEC should have waited for the legal challenge to play out before issuing final rules.

The factual basis for the SEC's rulemaking was equally flawed. Business lobbyists have claimed for years that proxy advisory firms' reports are rife with errors. The SEC recited these "concerns," but failed to provide evidence supporting them, and, when CII filed a [FOIA request](#) with the SEC

seeking evidence of its economic analysis of claims of errors, agency staff responded with a [memorandum](#) clarifying that the SEC did not do an assessment on its own to corroborate the veracity of the claims.

CII's [own research](#) concluded that the rate of factual errors in proxy advice is extremely low; most of the "concerns" the SEC cited are policy disputes or disagreements on methodology.

"The SEC should regulate based on firm legal grounds and evidence, not pressure from business lobbyists seeking to strengthen corporate control of the proxy voting process," said CII Executive Director Amy Borrus.

CII thinks the SEC's new directive that investment advisors review comments from companies in response to proxy advice sounds unobjectionable in principle. However, in practice, it could significantly delay voting and undermine the independence of proxy advisory firms. This approach is a significant departure from the SEC's original rule proposal that has never been tested in practice. We and other market participants have not had a chance to review it and evaluate how it would affect the complex, time-sensitive and important proxy voting process.

Likewise, CII is concerned that the final rule preserves the SEC's codification of its position that proxy advice may be challenged through legal actions, including the SEC's suggestion that evaluating a company based on corporate governance best practices that exceed minimum legal requirements may be misleading. If companies that don't like proxy advisors' methodology or advice threaten or resort to lawsuits to pressure proxy advisors, the independence and objectivity of proxy voting advice could be jeopardized.

"The SEC should strive to preserve investors' access to independent, objective advice, not make it harder for shareholders to hold corporate management at the companies they own accountable," Borrus said.

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About CII: *The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of U.S. asset owners, primarily pension funds, state and local entities charged with investing public assets, endowments and foundations, with combined global assets that exceed \$4 trillion. CII's associate members include non-U.S. asset owners with more than \$4 trillion in global assets, and a range of asset managers with more than \$40 trillion in global assets under management. CII is a leading voice for effective corporate governance, strong shareowner rights and sensible financial rules that foster fair, transparent and vibrant capital markets.*