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BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

Washington DC

In the Matter of:
File No. S7-23-19 – Exemptions from the Proxy Rules for Proxy Voting Advice

Ms. Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

Comments of
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On behalf of the Institute for Policy Innovation (IPI), a free-market public policy research organization that focuses our efforts on factors that affect economic growth, I appreciate this opportunity to share our thoughts for your consideration.

Our comments are in favor of the rulemaking. We believe that proxy advisory services have been permitted to accumulate disproportionate and inappropriate power over time, and that this power presents a number of potential harms to individual shareholders. We thank the Commission for undertaking this process and encourage not only these but also other actions to rein in the power of proxy advisory services in protection of individual investors. We would like to see the Commission do more, but the current proposed rulemaking is a good start.

Institutional investors own 70 percent of the outstanding shares of US publically traded companies. This gives institutional investors significant sway over corporate governance, which is not in itself problematic. But *these institutional investors support the recommendations of the two leading proxy advisory services 80 percent of the time*. That means that how ISS and Glass Lewis determine their recommendations and how they share those recommendations with shareholders is worthy of scrutiny, particularly in recognition of the fact that ISS and Glass Lewis control 97% of the proxy advisory market, and that in its wisdom the SEC has granted broad exemptions to these two firms from federal proxy rules. If the dominant duopoly of ISS and Glass Lewis wish to retain their exemptions, it is only reasonable that they be required to adopt policies designed to 1) increase transparency, 2) eliminate conflicts of interest, 3) improve analysis by giving companies opportunities to correct mistakes, wrong analysis and missing perspectives, and 4) prioritize shareholder value rather than the policy or political preferences of the proxy advisors themselves.

Individual Investors Should be Paramount

In theory, individual investors have both voice and exit, as they have an ability to vote their shares on shareholder resolutions, and they also have the ability to sell their shares if they don't like the way a particular company is being run. In practice, however, this isn't really true, as 1) most individual investors have their investments in mutual funds, pension funds and other retirement devices, and 2) these large institutional funds are managed by others on behalf of the individual investor.

We know what individual investors want from their investments. They want a focus on maximum returns over time, and that's pretty much it. For those few individual investors who want their investments to parallel their political or policy preferences, abundant investment vehicles exist for those purposes. If an investor does NOT choose those specialty vehicles, they are looking for maximum returns over time.

In a simple, theoretical situation, the institutional investors DO represent the interests of the individual investors and thus pursue maximum returns over time. However, increasingly there are situations where it is clear that the dominant proxy advisory services are making recommendations unrelated to the financial performance of the company, and sometimes even in conflict with maximum financial performance—recommendations that reflect the political, economic, or environmental preferences of the principles of the proxy advisory firms, or those of the major institutional managers.

Because most individual investors are passive with regard to corporate governance, and because even the major institutional investors tend to follow the recommendations of the major proxy advisory services, the primary concern of the individual investor—maximum returns over time—is sometimes getting sacrificed to other interests of the proxy advisory firm.

Intermediaries Should Not be Paramount

Some argue that reforms of the proxy advisory process are not necessary because the institutional investors—the ones who are the actual clients of proxy advisors—are not asking for reform.

But institutional investors are intermediaries, not the ultimate beneficiaries of their various funds. In general, it's safe to say that it's not the institutional investors' money—the money belongs to individuals who contribute directly or indirectly to those institutional funds, and for whom those funds are ultimately managed and directed. So the Commission must always keep in mind that, though it undoubtedly primarily interacts with institutional investors—those institutional investors should not be the Commission's primary concern.

The Commission should always keep primary in its considerations the workers who are socking their money away every week or every month in an IRA, a 401k, or similar retirement savings vehicle—or the worker whose pension is being funded by contributions from his or her employer. And conflicts of interest, lack of transparency, political or economic or environmental agendas all have impact on higher expenses and lower rates of return for the individual investors for whom the institutional funds ultimately exist.

Robovoting

Individual investors are almost entirely passive and trusting with their investments, and this is to be expected. Therefore, it is always likely that individuals will endorse the recommendations of their institutional managers or proxy advisors. Because of this, the Commission should take steps to ensure that the recommendations have integrity, are not the products of conflicts of interest, are based on accurate information, and do not simply represent the biases of the advisors.

Therefore, it’s critical that companies be given adequate time to respond to proxy advisor recommendations to ensure that recommendations are based on accurate information, or at least that contrary viewpoints are permitted. Proxy advisory recommendations should be required to contain responses contrary to the proxy advisor’s recommendations.

Transparency

There is an obvious problem when two dominant proxy advisory firms not only make governance and proxy voting recommendations for public companies they analyze, but also have some of those same companies as paying clients. ISS Corporate Solutions in particular presents a conflict of interest as it is a for-profit corporate consulting service. Do clients of ISS Corporate Solutions get more favorable treatment than non-clients? Inquiring minds want to know. ISS and Glass Lewis allow some companies access to a review process regarding its recommendations, but not all. These and other factors suggest an inadequate level of transparency in the proxy advisory business, but particularly with those exempt from federal proxy rules.

Abuse of Power

Because of individual investor passivity, and the tendency of even institutional investors to follow proxy advisors’ recommendations, there is a tremendous accumulation of power at the proxy advisory services. It is reasonable to assume that such power can be a temptation to proxy advisors to abuse this power, such as leveraging it to encourage companies themselves to become clients of proxy advisory services, and to use recommendations to push agendas that may be in conflict with the company’s ability to generate maximum returns.

Politicization of Proxy Recommendations

Our primary concern is that political agendas have become intermingled with proxy recommendations and pressure from institutional investors. We have a serious concern that proxy advisory firms sometimes advance agendas that are almost totally unrelated to issues affecting financial performance, and thus we would characterize these as political rather than financial or fiduciary matters.

We oppose any and all attempts to create governance standards for corporations other than maximizing shareholder value, and we oppose them whether they arise from legislation, regulation, or from the power of private proxy advisory services that have been permitted by the Commission to accrue an inappropriate amount of power over corporate governance.

Concern: Where Have All the Public Companies Gone?

There is no public policy principle under which to prefer public companies over private companies, but it is nonetheless indicative that *there are today half as many public companies in the U.S. as there were twenty years ago.*[i] The last time the Wilshire 5000 index consisted of 5,000 companies was in 2005; today, it is comprised of less than 3,500 companies. While there are many factors behind this shift, regulatory burden is certainly one of them.

From the standpoint of the investor, it is better for there to be more rather than fewer public companies. More choice makes more diversification possible. And from an economic growth standpoint, it would also seem that more public companies would create more efficiency. We would not purport to know what the “right” mix of public and private companies is, but we think it’s likely that the mix is being distorted today because of regulatory burden.

The fact that such a dramatic shift has taken place should indicate to the Commission that one or more unusual things have happened. We would suggest that one such development is the rise of *shareholder activism that is unrelated to financial performance, and manipulation and even borderline harassment of corporations by proxy advisors with their own agendas.*

Concern: How is Public Policy to be Determined under a Constitutional System?

What is the duty of corporate governance today? Is it maximizing shareholder value within the law? Or is it to be an agent of social change? Is it appropriate for government to insert itself between a corporate board and its fiduciary obligation, and conscript corporations to adopt and push non-financial objectives? How are corporate boards to determine between these often conflicting mandates? Would such conflicts be sufficient to drive a company private, or to convince a company to never go public?

We would suggest that, under our constitutional system, public policy changes are supposed to happen through legislation, a system designed for maximum representation and public input. It is utterly inappropriate for the financial elites to attempt to push their policy agendas onto society through harassment and arm-twisting of corporate governance through the pressure of proxy recommendations, taking advantage of investor passivity and robovoting.

Conclusion

We would be happy to work with the Commission to address these concerns through its current inquiry and rulemaking, and in future rulemakings. The Institute for Policy Innovation intends to inform and educate the public on this issue through op/eds, podcasts, conference and other public policy educational efforts. We trust the Commission will find these efforts to be of benefit in its efforts to serve the American investor and to protect the interests of individual investors.

Sincerely,

Tom Giovanetti

Tom Giovanetti
President

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[i] https://www.wsj.com/articles/where-have-all-the-public-companies-gone-1510869125