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January 17, 2012

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

VIA ELECTRONIC MAIL

Subject: Proposed Regulatory Framework for Proxy Advisory Firms

Dear Chairman Schapiro:

Recent public statements by you and your staff indicate that the Securities and Exchange Commission (“SEC”) will be moving forward to address the issues identified in the SEC Concept Release on the U.S. Proxy System, issued in July 2010 (“Concept Release”),¹ starting with a rulemaking proposal that will address proxy advisory firms.

The Shareholder Communications Coalition (“Coalition”)² has been advocating for quite some time that this regulatory process begin as soon as possible, and the Coalition applauds the SEC for recognizing that an update of its “proxy plumbing” rules now needs to occur.

We know the SEC has had a very active eighteen (18) months in promulgating new rules to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act. However, a number of these new rules—including the requirement of a shareholder advisory vote on executive compensation and the removal of broker discretionary voting authority on executive compensation matters—have made it even more imperative that the SEC address the shareholder communications and proxy voting issues raised in the Concept Release. While some of these issues are challenging, and many of these issues are quite complicated, we hope the Commission will move forward to address all of the issues raised in the Concept Release as soon as it is practicable for the agency to do so.

The Coalition is very supportive of the SEC’s interest in reviewing the

¹Concept Release on the U.S. Proxy System, Release Nos. 34-62495; IA-3052; and IC-29340, 75 Fed. Reg. 42,982 (July 22, 2010).

² The Shareholder Communications Coalition (“Coalition”) comprises the following associations: Business Roundtable, the National Investor Relations Institute, and the Society of Corporate Secretaries & Governance Professionals. The Securities Transfer Association is an associate member of the Coalition. More information about the Coalition and its activities can be accessed at www.shareholdercoalition.com.

appropriate regulation of proxy advisory firms under the federal securities laws, including the role of these firms in the proxy system and the processes used by these firms to generate voting recommendations and make voting decisions for their clients who retain such services.³ The SEC acknowledged in its Concept Release—and many commenters agree—that proxy advisory firms have considerable influence on the proxy process. This influence is also increasing, with more shareholder activism and the requirement of regular “say on pay” votes.

Despite their large role in proxy matters, proxy advisory firms remain generally unregulated and unsupervised, and substantial concerns have been raised about: (1) the conflicts of interest raised by several of their business practices; (2) a lack of transparency concerning their standards, procedures, and methodologies; and (3) their use of incorrect factual information to formulate specific recommendations.

As the SEC evaluates the role and legal status of proxy advisory firms, the Coalition has developed the following suggestions for the SEC to consider in connection with its development of a rulemaking proposal on this subject:

A. Proposed Regulatory Framework for Proxy Advisory Firms

1. **Regulatory Oversight of the Proxy Advisory Industry.** Proxy advisory firms should be subject to more robust oversight by the SEC. In this regard, the Coalition believes that any exemption from the proxy rules for proxy advisory firms⁴ should be conditioned on their meeting the requirements discussed below. In addition, the SEC should consider requiring proxy advisory firms to register as investment advisers, subject to a unique regulatory framework under the Investment Advisers Act of 1940.⁵

New SEC regulations should include minimum standards of professional and ethical conduct to be followed by the proxy advisory industry. The goal of a uniform code of conduct—which should address conflicts of interest, transparency of processes, and accuracy of factual information—should be to improve the quality and reliability of the analysis and advice provided by proxy advisory firms.

SEC regulation should require full disclosure of conflicts of interest by proxy advisory firms. A proxy advisory firm should publicly disclose its relationship with any client who is the proponent of a shareholder proposal or “vote no” campaign, whenever

³ See Letter from Niels Holch, Executive Director, Shareholder Communications Coalition, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, Oct. 20, 2010, at 29-32, [available at](http://www.sec.gov/comments/s7-14-10/s71410-206.pdf) <http://www.sec.gov/comments/s7-14-10/s71410-206.pdf>.

⁴ See Exchange Act Rule 14a-2(b)(3).

⁵ See 15 U.S.C § 80b-1 *et seq.* For example, the Investment Advisers Act imposes a fiduciary duty on investment advisers to act in the best interests of their clients by fully disclosing all potential conflicts of interest. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-93 (1963) (“The Investment Advisers Act thus reflects ... a congressional intent to eliminate, or at least to expose, all conflicts of interest which may incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.”).

the proxy advisory firm is issuing a recommendation to other clients in favor of the same proposal or “vote no” campaign.

Additionally, SEC rules should address whether a proxy advisory firm should be allowed to offer consulting services to any public company for which it is providing recommendations on how investors should vote their shares. If a proxy advisory firm is allowed to offer consulting services to such public companies, consideration should be given to ensuring that there is a complete and total separation of proxy advisory activities from all other businesses of the firm, including consulting and research services.

As the SEC develops a regulatory framework for proxy advisory firms, one possible avenue for guidance is the current and evolving regulation of credit rating agencies, or Nationally Recognized Statistical Rating Organizations (“NRSROs”). A review of Congressional and SEC actions with regard to NRSROs during the past several years shows that there are numerous and significant analogies with regard to problematic practices and regulatory improvements that should be considered for proxy advisory services.⁶

2. **Increased Transparency by Proxy Advisory Firms.** Given the tremendous influence of proxy advisory firms, there is a need for greater transparency about the internal procedures, guidelines, standards, methodologies, and assumptions used in their development of voting recommendations. This is particularly the case where they apply policies without taking into account company-specific or industry-specific facts and circumstances in making such voting recommendations. This increased transparency would permit shareholders and companies to better reconstruct and evaluate the advice rendered by proxy advisory firms.

Proxy advisory firms should be required to maintain a public record of all their voting recommendations. Consideration also should be given to requiring disclosure of the underlying data, information, and rationale used to generate specific voting recommendations. These disclosures could be made a reasonable time after the recommendation has been made and would still be relevant and useful to companies, academics, and others who study the influence of such firms.

3. **Accuracy of Factual Information Used by Proxy Advisory Firms.** Proxy advisory firms should be required to provide all public companies with draft reports in advance of distribution to their clients, to permit companies to review the factual information contained in these reports for accuracy. Companies should be permitted sufficient opportunity to conduct this review and to respond to any factual errors. Proxy advisory firms should then correct any factual errors. Consideration also should be given to whether these firms should be required to include in their reports any information they

⁶ See, e.g., Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-61050, 74 Fed. Reg. 63832 (Dec. 4, 2009); and Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-59342, 74 Fed. Reg. 6456 (Feb. 9, 2009).

receive from a company, or, at a minimum, disclosure in a report that a company disagrees with a particular factual assertion.

Proxy advisory services also should disclose publicly and promptly any errors made in executing or processing voting instructions on a particular proxy vote.

B. Proposed Improvements to the Institutional Investor Due Diligence Process

Along with evaluating the role and legal status of proxy advisory firms, the SEC and the Department of Labor should review the existing regulatory framework applicable to the use of proxy advisory firms by institutional investors. This review should evaluate whether such investors are exercising sufficient oversight responsibility with respect to their use of proxy advisory firms to satisfy their fiduciary duties. For example, are they using methodologies that are evaluating the facts and circumstances of each public company and are they avoiding “one-size-fits-all” or “check the box” methodologies?⁷

In addition, a review of the existing regulatory framework for proxy voting by institutional investors should include an evaluation of a 2008 ERISA interpretation by the Department of Labor, which clarified that there is no absolute duty to vote all portfolio shares on all matters. This interpretation stated that ERISA fiduciaries may conduct a cost-benefit analysis, comparing the cost of voting (including research costs) with the expected economic benefits of voting, before deciding on the matters with which to cast a vote.⁸

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The Coalition appreciates the opportunity to provide its views to the SEC, as it addresses the role and legal status of proxy advisory firms under the federal securities

⁷ See Millstein Center for Corporate Governance and Performance, Policy Briefing No. 3/Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry (Mar. 2, 2009), at 6, available at <http://millstein.som.yale.edu/Voting%20Integrity%20Policy%20Briefing%2002%2027%2009.pdf>. This paper discussed the underlying tension between an evaluation of the individual circumstances of a company and a more detailed, rules-based approach that requires fewer resources (“Debate in this area centered on whether it is more appropriate on the one hand, for investors and their advisors to develop general policies that are relatively flexible and then adjusted to fit the individual circumstances of the company under consideration; or on the other hand, to have far-reaching and detailed policies that generate consistent recommendations which allow possibly under-resourced proxy voting teams to vote without spending too much time considering the vote in the greater context of individual performance. When the proxy team is small, or governance resources sparse, this becomes a crucial issue.”).

⁸ This 2008 interpretation has been codified at 29 C.F.R. § 2509.08-2 (“If the responsible fiduciary reasonably determines that the cost of voting (including the cost of research, if necessary, to determine how to vote) is likely to exceed the expected economic benefits of voting, or if the exercise of voting results in the imposition of unwarranted trading or other restrictions, the fiduciary has an obligation to refrain from voting.”). See also Charles Nathan, “Future of Institutional Share Voting Revisited: A Fourth Paradigm,” Latham & Watkins Corporate Governance Commentary, Sept. 2011, available at http://www.lw.com/upload/pubContent/_pdf/pub4334_1.pdf.

The Honorable Mary L. Schapiro

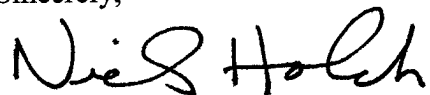
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laws and develops a rulemaking proposal to respond to the issues that have been raised by various stakeholders in the proxy system. The Coalition also looks forward to working with the SEC on the other issues raised by the Commission in its July 2010 Concept Release.

Thank you for your consideration of these views and please feel free to contact the Coalition with any questions or if you need additional information.

Sincerely,

A handwritten signature in black ink that reads "Niels Holch". The signature is written in a cursive, slightly slanted style.

Niels Holch
Executive Director
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cc: The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
The Honorable Daniel M. Gallagher
Meredith Cross, Director, Division of Corporation Finance
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