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Proposed SEC Rules Will Provide the Modern Governance Our Markets Need

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As our financial markets and businesses evolve, it's important that the regulations and oversight that govern them progress, too. Over the last year, the SEC has taken a series of steps as part of an important effort to modernize rules governing the proxy voting process, so that they reflect the realities of today's public market and ensure that the retail investors — who now largely depend on prudent decision-making from institutional investors — are sufficiently protected. Now the SEC is finalizing a rule on proxy advisors that will ultimately benefit companies and investors alike.

Over the last decade, investors have benefited from the rise of the market. This rise has also presented new challenges for corporate governance, among them the increasingly outsourced decision-making to proxy advisors on how to vote on shareholder proposals. This is problematic because proxy advisors are not currently accountable to the retail investors who provided the capital, have undisclosed conflicts of interest, and have issued factually inaccurate or flawed voting recommendations.

Many of the SEC's proposed rule changes are common sense reforms intended to address these issues and, most importantly, provide more transparency to those who vote the proxies. For instance, the proposal would require proxy advisors to disclose more information about potential conflicts of interest, and asked commenters to consider whether additional information should be disclosed about how they reach their recommendations in order to rely on certain regulatory exemptions outlined in the proposed rules.

The Commission's proposed solution to formalize the guidance on the definition of proxy solicitation it recently issued is also a simple, but elegant

fix. By codifying the definitions of "solicit" and "solicitation," the Commission is signaling that proxy advisors will be liable for false and misleading statements in their recommendations. In years past, this has not been the case. As such, this has resulted in proxy advisors publishing inaccurate or misleading information in their recommendations without any accountability. If these proposed rules are finalized and issued, retail investors, who depend on institutional investors to vote the shares of their holdings, will have certainty that the decisions on how those votes are being cast are not influenced by potential conflicts of interest on the part of proxy advisors, and, in the case of published recommendations containing inaccurate or misleading information, will be able to hold those proxy advisors accountable under securities law. These commonsense changes will bring proxy guidance into line with every other financial service and ensure that fiduciary duty is the primary consideration behind every recommendation.

In addition to providing more clarity, these proposed rules will allow a public company to review and respond to any misinformation or factual errors with a voting recommendation *before* it is published. At present, unless a public company subscribes to a proxy advisor's services or is part of the S&P 500 index, it doesn't have the ability to review and respond to any inaccuracies in a proxy voting recommendation before that recommendation is finalized. In the proposed rule, the SEC is recommending a time period where any public company, without having to subscribe to a proxy advisor's service, would have the opportunity to review and potentially comment on the validity of a recommendation before being sent to investors.

Proxy advisors and some investors have also objected by stating that these proposed reforms will not only "impede the independence of proxy voting research" but also will not provide investors enough time to review and consider recommendations.

To address these concerns, SEC Commissioner Elad Roisman has suggested that the SEC could consider a "contemporaneous review period for companies" within the voting recommendation process. Under this structure, companies and investment advisors would receive voting recommendations concurrently, and proxy advisors would be required to immediately notify clients if companies raised objections to their recommendations.

I believe this would be an effective compromise to respond to the concerns of both sides, provided one additional and essential step is also taken: the Commission must also prevent robo-voting from taking place.
Robo-voting is a common practice where some asset managers allow proxy advisors to automatically vote their shares in line with generic voting preferences set before the proxy season. If robo-voting is allowed to continue within a contemporaneous review system, votes will automatically be cast before companies have had the chance to highlight inaccurate statements within proxy advisor reports.

Commissioner Roisman has indicated that he is open to addressing what he terms as "set-it-and-forget-it" voting in the final rule, and even suggested enforcing a time period in which proxy advisors could be forced to disable robo-voting functions, a measure that will protect retail investors fiduciary interests by making sure investors have all the information they need before voting.

Unfortunately, proxy advisors and many fund managers oppose these proposed reforms because they are committed to the status quo of the current system, and how its lack of transparency is in their favor. Indeed, my colleagues in the investor relations profession have seen firsthand how certain fund managers attempt to intimidate their companies from disagreeing or speaking out against proxy advisor voting recommendations. This is why public companies, both major stock exchanges, the Department of Justice, and organizations such as the National Investor Relations Institute, the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness, the Society for Corporate Governance and the Shareholder Communications Coalition are in favor of these long overdue, proposed reforms.

Modern markets demand modern governance. It's been years since we've seen any meaningful updates to proxy advisory regulations, yet institutional ownership and reliance on proxy advisors have soared to new heights. The SEC's proposed reforms will address the realities of today's market and improve the transparency of the proxy voting process by significantly improving the quality of all the information needed to cast an informed vote.

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