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TARGETED REGULATION OF PROXY VOTING ADVICE: BALANCING MONITORING WITH INFORMATION FLOW IN THE AGE OF ESG

ABSTRACT

Proxy voting advice businesses have historically been guided by disjointed rules and regulations based on their relationship to other entities, but under a 2020 rulemaking they were officially brought under the auspices of the Securities and Exchange Commission. However, after a change in presidential administrations, the Securities and Exchange Commission in 2021 issued a proposed amendment which, if adopted, would rescind some of the more contentious elements of the initial 2020 rulemaking. This Note considers how, even if the 2021 proposed amendments are adopted, the Securities and Exchange Commission can simultaneously regulate and protect proxy voting advice businesses through the creation of an advisory review board within the Securities and Exchange Commission's Division of Corporation Finance. This board would serve to protect the independent source of information which specialty voting groups have come to rely upon, while also promoting the Securities and Exchange Commission's goals of transparency and accuracy.

INTRODUCTION

On July 22, 2020, the Securities and Exchange Commission (SEC) voted 3-2 to adopt amendments to its rules governing proxy voting advice businesses (PVABs).¹ These amendments, Exemptions from the Proxy Rules for Proxy Voting Advice (the 2020 Final Rules), introduced conditional exemptions from the filing and information requirements, and expanded the regulatory framework governing PVABs, officially bringing PVAB advice under the governance of the Securities Exchange Act of 1934 (the Exchange Act).² The amendments introduced three general changes, they: (i) amended the definition of “solicitation” to specifically include PVAB advice and recommendations, thereby making PVABs subject to all the Exchange Act regulations of proxy solicitations (the Proxy Rules); (ii) imposed two conditions that PVABs must meet to in order to rely upon the exemptions from the standard information and filing requirements of the Proxy Rules;

1. Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate, and Complete Information (July 22, 2020), [hereinafter 2020 Final Rules Press Release].

2. See Exemptions from the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 89,372, 85 Fed. Reg. 55,082 (July 22, 2020) [hereinafter 2020 Final Rules].

and (iii) explicitly imposed liability on PVABs for fraud.³ As investor focus shifts towards environmental, social, and governance (ESG) concerns,⁴ such changes were highly criticized for their predicted onerous impact on PVABs,⁵ which often provide voting recommendations for ESG-oriented funds.⁶ After a change in administrations, the SEC under President Joseph Biden has proposed revisions of the 2020 Final Rules (the 2021 Proposed Rules)⁷ which aim to repeal the most contentious and onerous conditions of the 2020 Final Rules: the issuer feedback prerequisite and the explicit imposition of fraud liability.⁸

The amendments to the Proxy Rules of the Exchange Act to demand more transparency and accuracy of PVABs are beneficial not only to the standard shareholder, but especially to specialty voting groups which advocate for less traditional shareholder benefits, i.e., benefits other than pure financial gain. Particularly, the furnishing of company responses to PVAB recommendations on company resolutions increases information available to shareholders, which should be of particular importance to those investors with specialty interests. The primary concern of these specialty investors is that the amended rules will create undue burden on what they perceive to be an already perfectly working system, thereby increasing cost and actually triggering an information decrease. Such concern is valid since the 2020 Final Rules effectively gave companies a chance to rebut PVABs recommendations directly to PVAB clients.⁹ However, the beneficial outcomes of the amendments are twofold: first, the additional requirements primarily affect PVABs with increased potential conflicts of interest, i.e., those which possess consulting businesses or additional services, and, therefore, may open the market up for increased competition from smaller PVABs which may escape the cost burden; second, if utilized correctly, the process demanded by the SEC will create a superior dissemination of accurate information that specifically benefits those with unique interests like specialty funds.

This Note proposes that, in order to address the fears of smaller investors and specialty voters, the 2020 Final Rules should be supplemented by the

3. 2020 Final Rules Press Release, *supra* note 1; Cydney Posner, *SEC adopts amendments regarding proxy advisory firms (updated)*, COOLEYPUBCO (July 24, 2020), <https://cooleypubco.com/2020/07/24/sec-amendments-proxy-advisors-updated/>.

4. Michelle Winters, *ESG proxy voting takes center stage*, GOBY, (Feb. 22, 2022) <https://www.gobyinc.com/esg-proxy-voting-takes-center-stage/>.

5. Amendments to the Proxy Rules for Proxy Voting Advice, 86 Fed. Reg. 67, 383 (Nov. 26, 2021) [hereinafter 2021 Proposed Rules].

6. See David Bixby & Paul Hudson, *Glass Lewis, ISS, and ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 3, 2019), <https://corpgov.law.harvard.edu/2019/07/03/glass-lewis-iss-&-esg/>.

7. Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Rule Amendments to Proxy Rules Governing Proxy Voting Advice (Nov. 17, 2021) [hereinafter 2021 Proposed Rules Press Release].

8. 2021 Proposed Rules, *supra* note 5.

9. PVABs must provide a "mechanism" for shareholders to access any responsive statement provided by the corporate issuer. See 2020 Final Rules, *supra* note 2.

creation of an advisory review board within the SEC's Division of Corporation Finance to directly and expeditiously handle complaints by corporate issuers who are the target of the recommendations during the proxy season, and to monitor the recommendation and voting process. Part I of this Note will discuss the historical background of PVABs in the United States and the problems the SEC sought to address through these latest amendments. Then, Part II will address the vehicle through which the SEC sought to regulate PVABs, the 2019 Proposed Rules, and reactions to the proposal. Part III will outline the 2020 Final Rules and the reactions to their adoption. Part IV will discuss the interplay between specialty voting groups and PVABs, specifically the importance of ESG funds. Finally, Part V offers a solution that prioritizes the needs of these specialty groups while maintaining accountability for PVABs.

I. THE HISTORY OF THE PROXY VOTING ADVICE BUSINESS

Shareholder involvement and participation in public companies has reached an exceptional level, leading to an equally extraordinary level of engagement by the institutional investors who represent them.¹⁰ Increased shareholder engagement is the culmination of a range of factors, but mostly credited to the boom in proxies voted by institutional investors (and subsequently, the rise of PVABs). Factors leading to heightened involvement include greater institutional ownership of public stocks, institutional ownership of more diverse portfolios, and an increase in ownership through passive index funds.¹¹

Increased engagement has been attributed, in part, to regulatory changes made by the SEC to Rule 14a-8 of the Exchange Act in 1983,¹² and to New York Stock Exchange Rule 452.3¹³ through its authority in Rule 19(b) of the Exchange Act.¹⁴ However, much of the more impactful change is a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

10. BUSINESS ROUNDTABLE, *Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 8, 2016), <https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/> (noting that most often shareholders are authorizing members of management to vote their shares as indicated on their proxy cards).

11. Michael Cappucci, *The Proxy War Against Proxy Advisors*, 16 N.Y.U. J.L. & BUS. 579, 582 (2020).

12. Séan Patrick O'Brien, *The 1983 Amendments to SEC Rule 14A-8: Upsetting a Precarious Balance*, 19 VAL. U. L. REV. 221, 281 (1984).

13. NYSE Rule 452.3.

14. Press Release, U.S. Sec. & Exch. Comm'n, Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company (July 1, 2009).

(the Dodd-Frank Act).¹⁵ For example, the Dodd-Frank Act created the “Say-on-Pay” rule, which requires corporations to hold shareholder votes on executive compensation packages at least once every three years, as well as rules that facilitate active shareholder participation in nominating directors and proposing bylaws.¹⁶ The addition of these matters requiring mandatory shareholder votes in turn dramatically increased the need for more efficient and inexpensive research to perform informed voting.

By 2019, institutional investors¹⁷ made up 70% of public company ownership and voted at a 90% participation rate.¹⁸ Along with the increased number of proxies that institutional investors are required to vote came an amplified obligation to vote informed and to advocate for their shareholder’s best interests.¹⁹ The sheer volume of votes to be cast created a dilemma—how can one responsibly cast votes on thousands of proposals which all occur within the same limited time frame?

Enter the PVABs: entities that, for a fee, issue guidance to institutional investors on proxy voting for a variety of corporate matters that arise at annual shareholder meetings, most notably executive compensation and corporate governance.²⁰ PVABs emerged to fill an industry gap, as most businesses do, created by the old “Wall Street Rule:” that investors must vote with management or sell their shares.²¹ Traditionally, the only way for a shareholder to have any real power over company operations would be through an old-fashioned intense and expensive proxy fight for management

15. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78n-1).

16. *Id.*

17. *Institutional vs. Retail Investors: What’s the Difference?*, INVESTOPEDIA, (Dec. 6, 2021), [https://www.investopedia.com/ask/answers/06/institutionalinvestor.asp#:~:text=An%20institutional%20investor%20is%20a,like%20401\(k\)s](https://www.investopedia.com/ask/answers/06/institutionalinvestor.asp#:~:text=An%20institutional%20investor%20is%20a,like%20401(k)s) (explaining that institutional investors are (generally) organizations which trade bulk amounts of securities with expertise like “pension funds, mutual funds, money managers, insurance companies, investment banks, commercial trusts, endowment funds, hedge funds, and also some private equity investors.”); *What is the difference between retail and institutional investors?*, YIELDSTREET, (Jan. 9, 2020), <https://www.yieldstreet.com/resources/article/retail-vs-institutional-investors>, (noting that institutional investors are entities that do not use their own money but rather invest on behalf of individual members who own shares of the entity itself, as opposed to retail investors who are non-professional individual investors who own their shares indirectly through a broker-dealer, bank, or other authorized financial advisor).

18. *2019 Proxy Season Review*, BROADRIDGE & PWC, https://www.broadridge.com/_assets/pdf/broadridge-proxy-pulse-2019-review.pdf (finding that by comparison, 30% of public company ownership was held by retail investors, individuals or those who own through brokerage firms, who vote at a rate of 28%).

19. SEC Staff Legal Bulletin No. 20 on Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, (June 30, 2014) (confirming that investment advisers have a duty to vote proxies on their clients’ behalf).

20. *Proxy Advisory Firms*, CTR. ON EXEC. COMP., <https://execcomp.org/Issues/Issue/proxy-advisory-firms> (last visited Oct. 10, 2020).

21. See Alan R. Palmiter, *Mutual Fund Voting of Portfolio Shares: Why Not Disclose?* 23 CARDOZO L. REV. 1419, 1430 (2002).

control.²² Prior to the existence of PVABs, most institutional investors simply voted along with management since the cost to conduct independent research was often too burdensome.²³ Predictably, investors jumped to hire PVABs to do the leg work for them to carry out their fiduciary obligations. From the most optimistic point of view, the existence and service of PVABs allows institutional investors to vote intelligently and responsibly.²⁴

A. WHAT IS PROXY VOTING?

Publicly-traded companies have annual meetings at which they put forth a variety of proposals for their shareholders to vote on.²⁵ Many of these meetings take place between mid-April and mid-June—this time is known as the proxy voting season.²⁶ Investors who own shares as of the record date for the vote, known as “record holders” or “registered owners,” are entitled to vote their shares in person at these meetings.²⁷ However, most investors do not vote in person because they often do not reside in the company’s state of incorporation.²⁸ Most shareholders, instead, authorize a “proxy” which allows the proxy holder, who is frequently the company itself, to vote the authorizing record holder’s shares in accordance with their instructions.²⁹ Those who are beneficial owners³⁰ must fill out a “voting instruction form,” which directs the investment adviser through which they own their shares to vote a certain way on each proposed resolution.³¹ Investment advisers have a

22. George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1288 n.1, 2 (2014).

23. *See id.*

24. *See id.*

25. *Spotlight on Proxy Matters – The Mechanics of Voting*, U.S. SEC. & EXCH. COMM’N, https://www.sec.gov/spotlight/proxymatters/voting_mechanics.shtml (last visited Oct. 10, 2020).

26. James Copland, *Proxy Monitor 2020: Proxy Season in a Pandemic*, MANHATTAN INST. (Apr. 21, 2020), <https://www.manhattan-institute.org/proxy-monitor-2020-proxy-season-in-pandemic#:~:text=Now%20proxy%20season%20begins%20in,total%20of%2061%20shareholder%20proposals.>

27. *Spotlight on Proxy Matters—Receiving Proxy Materials*, U.S. SEC. & EXCH. COMM’N, https://www.sec.gov/spotlight/proxymatters/proxy_materials.shtml#what_is_registered_owner (last visited Feb. 22, 2020); Alternatives to in-person voting are by mail, by phone, or via the internet through a secure website offered by the company. *What are the mechanics of voting either in person or by proxy?*, U.S. SEC. & EXCH. COMM’N, <https://www.investor.gov/what-are-mechanics-voting-either-person-or-proxy> (last visited Oct. 10, 2020).

28. *How do I vote at a corporate election?*, U.S. SEC. & EXCH. COMMISSION, <https://www.investor.gov/how-do-i-vote-corporate-election> (last visited Oct. 10, 2020).

29. *Id.*

30. A beneficial owner is one who enjoys the benefits of stock ownership, without actual ownership of title. The registered owner is often a broker. James Chen, *Beneficial Owner*, INVESTOPEDIA, <https://www.investopedia.com/terms/b/beneficialowner.asp> (last visited Oct. 10, 2020).

31. *What is the difference between registered and beneficial owners when voting on corporate matters?*, U.S. SEC. & EXCH. COMMISSION, <https://www.investor.gov/what-difference-between-registered-and-beneficial-owners-when-voting-corporate-matters> (last visited Oct. 10, 2020); *Spotlight on Proxy Matters – Receiving Proxy Materials*, U.S. SEC. & EXCH. COMMISSION, https://www.sec.gov/spotlight/proxymatters/proxy_materials.shtml (last visited Oct. 10, 2020).

fiduciary duty to vote proxies.³² The problem arises where these investment advisers and asset managers are large institutions who must cast billions of votes on thousands of proposals each season.³³

B. PVABS IN U.S. MARKETS

Institutional Shareholder Services (ISS) is the largest, and oldest, voting advice business in the United States,³⁴ serving around 1,500 institutional clients globally and producing over 42,000 proxy recommendations annually.³⁵ ISS also maintains a corporate governance consulting business, ISS Corporate Solutions, which advises companies on their internal approach to executive compensation, corporate governance, and sustainability programs, specifically to “manage the needs of a diverse shareholder base.”³⁶

Glass Lewis & Co. (Glass Lewis) is a close second to ISS with around 1,300 institutional clients in its portfolio.³⁷ It follows ISS in making recommendations for over 20,000 shareholder meetings annually.³⁸ Together, it is estimated that ISS and Glass Lewis make up 97% of the proxy

32. SEC Staff Legal Bulletin No. 20, *supra* note 19 (confirming that investment advisers have a duty to vote proxies on their clients’ behalf, and that obligation is accompanied by the duties of prudence and loyalty); Keith Johnson, Cynthia Williams & Ruth Aguilera, *Proxy Voting Reform: What Is on the Agenda, What Is Not on the Agenda, and Why It Matters for Asset Owners*, 99 B.U. L. REV. 1347 (2019); Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Release No. 5325, 82 Fed. Reg. 47420 (Aug. 21, 2019) [hereinafter Investment Advisers Guidance] (establishing that advisers do not need to vote on every matter to fulfill fiduciary duty; the SEC instructs advisers to make reasonable investigation into recommendations of PVABs retained to issue proxy voting advice).

33. Scott Fenn, *A Call for Change in the Proxy Advisory Industry Status Quo: The Case for Greater Accountability and Oversight*, CTR. ON EXEC. COMP. at 1 (Jan. 2011), <https://online.wsj.com/public/resources/documents/ProxyAdvisoryWhitePaper02072011.pdf>.

34. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-17-47, CORPORATE SHAREHOLDER MEETINGS: PROXY ADVISORY FIRMS’ ROLE IN VOTING AND CORPORATE GOVERNANCE PRACTICES (Nov. 2016), at 6, <https://www.gao.gov/assets/690/681050.pdf> [hereinafter the GAO Report]. “ISS, founded in 1985, provides research and analysis of proxy issues, custom policy implementation, vote recommendations, vote execution, governance data, and related products and services. ISS also provides advisory/consulting services, analytical tools, and other products and services to corporate issuers through ISS Corporate Solutions, Inc. (a wholly owned subsidiary). ISS is owned by Vestar Capital Partners, a private equity firm, and company management.”

35. *Proxy Voting Services*, INSTITUTIONAL S’HOLDER SERV., <https://www.issgovernance.com/solutions/proxy-voting-services/> (last visited Oct. 8, 2020).

36. *The ICS Story*, ISS CORP. SOL., <https://www.isscorporatesolutions.com/our-story/> (last visited Feb. 22, 2022); GAO Report, *supra* note 34.

37. *Company Overview*, GLASS LEWIS, <https://www.glasslewis.com/company-overview/> (last visited Oct. 8, 2020).

38. *Id.*; Glass Lewis’ case-by-case research is provided through their Proxy Paper® service. *Proxy Research – Proxy Paper®*, GLASS LEWIS, <https://www.glasslewis.com/proxy-research-3/> (last visited Oct. 8, 2020).

voting advice market.³⁹ Much smaller PVABs include Egan-Jones Proxy Services (Egan-Jones), Segal Marco Advisers, and ProxyVote Plus.⁴⁰

PVABs generally serve institutional stockholders who, collectively, own large chunks of the market and oftentimes substantial portions of each company.⁴¹ While some of the largest and the most powerful investors like BlackRock, Vanguard, and State Street (the Big Three)⁴² can afford to internalize the proxy voting analysis process, many other substantially-sized institutional investors without the capital to fund this intensive research contract PVABs to do the legwork.⁴³ PVABs issue both voting recommendations, as well as research memoranda supporting their recommendations, to their clients.⁴⁴

C. THE PREEXISTING FRAMEWORK

An institutional investor is a legal entity that collects capital from numerous organizations and investors and uses those funds to invest in a variety of profitable financial instruments on behalf of those members.⁴⁵ Examples of institutional investors include those regulated by the SEC like mutual funds and Exchange Trading Funds (ETFs), as well as entities like pension plans, insurance companies, hedge funds, and other managed accounts which may not be within the SEC's scope of regulation.⁴⁶

39. James K. Glassman & Hester Peirce, , *How Proxy Advisory Services Became So Powerful* MERCATUS CTR. AT GEO. MASON UNIV. (June 18, 2014), <https://www.mercatus.org/system/files/Peirce-Proxy-Advisory-Services-MOP.pdf>. One of the authors of this article, Hester Peirce, was later appointed to serve on the SEC as of January 2018. *Biography, Commissioner Hester M. Peirce*, U.S. SEC. & EXCH. COMMISSION, <https://www.sec.gov/biography/commissioner-hester-m-peirce#:~:text=Biography&text=Peirce,Hester%20M.,in%20on%20January%2011%2C%202018>.

40. James R. Copland, David F. Larcker & Brian Tayan, *Proxy Advisory Firms: Empirical Evidence and the Case for Reform*, MANHATTAN INST. (May 2018), <https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf> (Egan-Jones Proxy Services does not disclose its numbers of clients or meetings served, Segal Marco Advisers has 600 clients, and ProxyVote Plus serves just 150 clients).

41. Fenn, *supra* note 33.

42. The Big Three are BlackRock, Vanguard, and State Street Global Advisors, who hold approximately more than 20% of S&P 500 companies. Because of their fiduciary obligation they are more likely to vote their shares, and since they have such broad ownership they control, in reality, around 25% of the votes in the average S&P 500 company that they own stock in. Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 721-41 (2019).

43. Frank M. Placenti, *Are Proxy Advisors Really a Problem?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 7, 2018), <https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-really-a-problem/#7b>.

44. Andrey Malenki, Nadya Malenko & Chester S. Spatt, *Creating Controversy in Proxy Voting Advice*, CLS BLUESKY BLOG (June 14, 2021) <https://clsbluesky.law.columbia.edu/2021/06/14/creating-controversy-in-proxy-voting-advice/>.

45. *Institutional Investor*, CORP. FIN. INST., <https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/institutional-investor/> (last visited Oct. 5, 2020).

46. Luis A. Aguilar, *Institutional Investors: Power and Responsibility*, U.S. SEC. & EXCH. COMM'N (April 19, 2013), <https://www.sec.gov/news/speech/2013-spch041913la.htm>.

Prior to the adoption of the 2020 Final Rules, there was no dedicated scheme for regulating PVABs. Instead, the interactions of institutional investors with PVABs like ISS⁴⁷ and Glass Lewis were governed by a regulatory framework that relied upon their relationship to investment advisers. The framework was derived from three sources: (1) a Department of Labor (DOL) response letter in 1988 clarifying that pension funds have a fiduciary duty to their clients to vote proxies in the best interest of those clients;⁴⁸ (2) a 2003 rule under the Investment Company Act of 1940 requiring mutual funds to adopt policies and procedures that ensure proxy votes are cast in the best interest of clients and to disclose their proxy voting records publicly;⁴⁹ and (3) Investment Advisers Act of 1940 (Advisers Act) Rule 206(4)-6 which requires registered investment advisers to adopt “policies and procedures reasonably designed to ensure that you vote client securities in the best interest of clients,” and that addresses conflicts of interest and information to be disclosed to clients.⁵⁰ The end result was a loose framework without a designated central authority to act as a watchdog, though the SEC assumed this role due to the previously uncodified but long-standing classification of proxy recommendations as “solicitations” under Rule 14a of the Proxy Rules.⁵¹

D. THE JOURNEY TO REGULATION

The official adoption of these amended rules marks the climax of a long process by the SEC to make changes in the way PVABs operate.⁵² In 2004, the SEC released two critical no-action letters to Egan-Jones and ISS (No-Action Letters).⁵³ The No-Action Letters held that investment advisers would

47. *Regulatory Code of Ethics*, INSTITUTIONAL S’HOLDER SERVS. (June 2017), <https://www.issgovernance.com/file/duediligence/iss-regulatory-code-and-exhibits-june-2017.pdf> (ISS is a registered investment adviser subject to regulation under the Advisers Act).

48. Cappucci, *supra* note 11 at 586 n.26.

49. Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8,188, Exchange Act Release No. 47,304, Investment Company Act Release No. 25,922, 17 C.F.R. pts. 239, 249, 270, 274 (Apr. 14, 2003).

50. Proxy Voting 17 C.F.R. § 275.206(4)-6 (2022).

51. Concept Release on the U.S. Proxy System, Exchange Act Release No. 62,495, Investment Advisers Act Release No. 3,052, Investment Company Act Release No. 29,340, 95 Fed. Reg. 42,982 (July 22, 2010) (to be codified at 17 C.F.R. pts. 240, 270, 274, 275) [hereinafter Concept Release] (providing at II(D)(5) that this is advertised as a longstanding view of the SEC); *see* 2020 Final Rules, *supra* note 2 (citing to two SEC releases from 1964 and 1979 which define PVAB advice as solicitations).

52. Chairman Clayton explained that the SEC fully intends on continuing this process of revamping the Proxy rules: “Our work to modernize and enhance the accuracy, transparency and effectiveness of our proxy voting continues, including efforts to address ‘proxy plumbing’ and ‘universal proxy.’” Jay Clayton, Chairman, U.S. Sec. & Exch. Comm’n, Testimony on “Oversight of the Securities and Exchange Commission” (Nov. 17, 2020).

53. Egan-Jones Proxy Servs., SEC No-Action Letter, U.S. SEC. & EXCH. COMM’N (May 27, 2004), <https://www.sec.gov/divisions/investment/noaction/egan052704.htm>; Inst’l S’holder Servs., Inc. SEC No-Action Letter, U.S. SEC. & EXCH. COMM’N (Sept. 15, 2004), <https://www.sec.gov/divisions/investment/noaction/iss091504.htm>; Public Statement, U.S. Sec. & Exchange Comm’n,

be permitted to accept guidance from PVABs and remain in compliance with their fiduciary duties to their clients, so long as they adopted policies and procedures which would ensure that the PVABs had no conflicts of interest and aligned with their outlined policies of issuing advice.⁵⁴

The SEC issued a concept release concerning the U.S. proxy voting system in July of 2010,⁵⁵ asserting that the activities conducted by PVABs fall under the SEC's definition of solicitation in Rule 14a-1(I).⁵⁶ It additionally cited a concern that the existing regulatory framework may be tied to a "misalignment" of voting power and economic interest which would be cause for an institutional lack of faith in the accuracy of shareholder voting and thus the proxy voting system.⁵⁷ The release identified the existence and use of PVABs as a significant part of the decreasing trust.⁵⁸

In June of 2014, the SEC issued a Staff Legal Bulletin providing guidance to investment advisers regarding their responsibilities relating to PVABs, and to PVABs regarding two exemptions to the Proxy Rules that PVABs requested to use.⁵⁹ The SEC stated that PVABs were entitled to only one exemption, provided certain disclosures were made to institutional advisers.⁶⁰ In November of 2018, the SEC hosted a Roundtable on the Proxy Process which covered the contemporary framework, the shareholder proposal process, and the regulation of PVABs.⁶¹ The SEC withdrew its No-Action Letters in September of 2018 in anticipation of this event.⁶²

The SEC in August of 2019 again issued interpretive guidance for investment advisers regarding their proxy voting.⁶³ The guidance, among other things, set out steps advisers should take when deciding to hire a PVAB, steps they should take when determining the credibility of the

Statement Regarding Staff Proxy Advisory Letters (Sept. 13, 2018) (reporting that the SEC later withdrew these letters in September of 2018 as it geared up for its Roundtable on the Proxy Process).

54. Cappucci, *supra* note 11 at 587.

55. Concept Release, *supra* note 51.

56. *Id.* (noting at II(D)(5) that this is advertised as a longstanding view of the SEC).

57. *Id.* at 43008.

58. *See id.* This association with PVABs and a diminution of trust is evident in the stated purpose of the 2019 Proposed Rules and the 2020 Final Rules, which both state an overall goal of allowing investors to receive "accurate, transparent, and complete information" from PVABs.

59. SEC Staff Legal Bulletin No. 20, *supra* note 19 (namely, PVABs were not entitled to use the exemption in 14a-2(b)(1) if it was found they established specific voting guidelines before receiving the proxy materials, instead of simply issuing recommendations, and could utilize 14a-2(b)(3) which exempted proxy voting advice from those with whom the adviser has a business relationship).

60. *Id.*

61. *Spotlight on Proxy Process, November 15, 2018: Roundtable on Proxy Process*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/proxy-roundtable-2018#:~:text=November%2015%2C%202018%3A%20Roundtable%20on%20the%20Proxy%20Process&text=The%20event%20provided%20a%20public,role%20of%20proxy%20advisory%20firms>.

62. Statement Regarding Staff Proxy Advisory Letters, *supra* note 53.

63. Investment Advisers Guidance, *supra* note 32.

recommendations they receive, and clarified their fiduciary duties with respect to proxy voting.⁶⁴

E. PROBLEMS AND CRITIQUES

The proxy advisory business has been under fire since its inception.⁶⁵ Critics of the proxy voting advice business include corporate issuers,⁶⁶ independent research institutes,⁶⁷ and think-tanks. Even foreign think-tanks⁶⁸ have rattled off complaints. There are several major complaints that are made about PVABs generally:

1. “Robo-voting”: an Over-Reliance on PVABs

One contentious complaint is that PVABs enable “robo-voting,” where clients automatically vote along the recommendations of PVABs without evaluating the advice independently, and that robo-voting happens quite frequently.⁶⁹ This is the clearest impetus for increased regulation of PVABs—with near total control, it would be unreasonable to allow their recommendations to undergo minimal scrutiny.

64. Namely that the duty to vote proxies in the client’s best interest does not require advisers to actively vote on all proxy matters. *Id.*

65. “Almost from the time the industry was created, proxy advisory firms have been criticized for providing product offerings or ownership structures that could compromise the analyses they provide.” Fenn, *supra* note 33.

66. Corporate issuers are on the receiving end of the PVAB advice/recommendations and are in some ways at the mercy of the recommendations against them. See Adam Hayes, *Issuer, INVESTOPEDIA* (updated Jun. 26, 2020) <https://www.investopedia.com/terms/i/issuer.asp#:~:text=Key%20Takeaways-,An%20issuer%20is%20a%20legal%20entity%20that%20develops%2C%20registers%20and,shares%2C%20bonds%2C%20and%20warrants>.

67. One empirical study in 2018 set out to dig deeper into PVABs and came away with alarming conclusions: 1) PVABs lack transparency; 2) despite PVABs recommendations being just that, recommendations, institutional investors are considerably swayed by such recommendations—particularly in proxy contests, Say-on-Pay voting, and equity compensation plans; 3) corporations adjust their own policies based on PVABs guidelines, which was found to be *harmful* to shareholders; and 4) there is some evidence that PVABs recommendations may not actually be beneficial to shareholders due to the economic ties between PVABs and issuing companies. *Proxy Advisory Firms: Empirical Evidence and the Case for Reform*, *supra* note 40.

68. There is a particular criticism of PVAB input on Say-on-Pay votes as “value-destroying” and claiming that they have “no particular expertise in this field and no genuine experience in the matter” to legitimize their recommendations. Yvan Allaire, *The Troubling Case of Proxy Advisors: Some Policy Recommendations*, INST. FOR GOVERNANCE OF PUB. & PRIV. ORG. (Jan. 2013), <https://www.sec.gov/comments/4-725/4725-4549663-176173.pdf>.

69. *New Report Highlights Impact & Extent of Flawed Proxy Advisor Recommendations*, AM. COUNS. FOR CAP. FORMATION (Oct. 29, 2018), <http://accf.org/2018/10/29/new-report-highlights-impact-extent-of-flawed-proxy-advisor-recommendations/>; Tim Doyle, *The Realities of Robo-Voting*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 29, 2018), <https://corpgov.law.harvard.edu/2018/11/29/the-realities-of-robo-voting/> (citing data that 175 of the largest asset managers who control \$5 trillion in assets vote along with ISS 95% of the time. However, the provider of the data underlying the claims in the article, Proxy Insight, responded, repudiating the claims and criticizing the ulterior motives of the author and their backers as biased against PVABs. The data provider emphasized the lack of truth behind Doyle’s claims).

Though a majority of studies state that the recommendations tend to sway the votes of clients significantly,⁷⁰ there are also studies that show that they are not followed to the letter, particularly for matters of ESG.⁷¹ Some findings show that when adjusting the metrics measuring PVAB influence in voting, which generally show a large overlap in recommendations and actual voting records, ISS recommendations wind up materially affecting a much smaller portion of shareholder votes.⁷² Many advisors assert that they use PVABs to issue recommendations along customized guidelines, rather than the PVABs' own boilerplate guides.⁷³ Another alternative perspective paints PVABs as issue-spotters to identify key matters for institutional investors to critically analyze before voting.⁷⁴

2. Conflicts of Interest: Biased Recommendations and Allegations of Ulterior Motives

The SEC amendments seek to directly attack the perceived conflict of interests of some PVABs. ISS is a particular target of this criticism because it offers consulting services on corporate governance matters, leading some companies to state they feel pressure to utilize those services to obtain favorable recommendations.⁷⁵ While ISS maintains a firewall and other preventative measures to deal with potential conflicts,⁷⁶ there have been signs

70. Tao Li, *Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry*, 64 MGMT. SCI. 2951, 2952 (2018) (“estimated to sway between 13-30% of shareholder votes, depending on the type of proposal”).

71. Kevin Chuach, Isobel Mitchell, & Lily Tomson, *Another Link in the Chain: Uncovering the Role of Proxy Advisors in Investor Voting*, SHAREACTION FOR THE CHARITIES RESPONSIBLE INV. NETWORK (Aug. 2019), https://api.shareaction.org/resources/reports/Another-Link-in-the-Chain_Uncovering-the-role-of-proxy-advisors-in-investor-voting.pdf (finding that for the 2019 voting season ISS was more supportive of ESG resolutions than most institutional investors, and there is minimal evidence supporting the conclusion that, in the realm of ESG-friendly proposals, investors over-rely on PVAB recommendations).

72. Stephen Choi, Jill Fisch, & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L. J. 869, 906 (2010) (finding that the popular statements of ISS power over voting is really only controlling over 6-10% of the shareholder votes, and that the majority of ISS's influence as PVAB is not as a means of robo-voting but rather as an information agent to condense crucial information for its clients); GAO Report, *supra* note 34. (“The study also found that the relationship between proxy advisory firm recommendations and shareholder votes varies based on the rationale behind the recommendation and the institutional investor's ownership structure. For example, the relationship between negative recommendations and shareholder votes is weaker for shareholders with larger holdings and, thus, presumably greater incentives to perform their own internal research. The study concluded that this suggests that at least some shareholders are not directly influenced by the recommendations and take into account the underlying basis for the recommendation and other relevant factors.”)

73. Cydney S. Posner, *What Happened at the SEC's Proxy Process Roundtable?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 21, 2018).

74. Douglas Sarro, *Proxy Advisors as Issue Spotters*, 15 BROOK. J. CORP. FIN. & COM. L. 371, 374 (2021).

75. Li, *supra* note 70, app. A.

76. 2020 Final Rules, *supra* note 2.

that suggest conflicts of interest are not necessarily an unfounded concern.⁷⁷ Furthermore, evidence discussed in Section IV.C may suggest that ISS votes in alignment with labor union proposals, propelling accusations of ideological bias.⁷⁸

There is also specific attention focused on Glass Lewis here because it is itself owned by two institutional investors, Alberta Investment Management Corporation and Ontario Teachers' Pension Plan, which at times put forth their own proposals,⁷⁹ creating questions about objectivity.⁸⁰ Though they do not offer consulting services to corporate issuers or directors, shareholder proposal advocates, or opponent shareholders in control contests like ISS, Glass Lewis discloses potential conflicts on the cover page of any recommendation reports it issues.⁸¹

Recent research may suggest that, although clients primarily contract with PVABs for their supportive research, thus incentivizing objective and thorough recommendations, PVABs are also motivated to provide controversial recommendations.⁸² The controversy drives closer vote outcomes, which in turn increases the future flow of business to PVABs by those shareholders seeking to decide an apparently "tight" race.⁸³ This conflict of interest therefore can skew PVAB recommendations.

Opponents further allege that PVABs have no real stake in the outcome of the proposals they make recommendations on. That is, because they have no financial interest in the outcome, they are able to recommend votes that align with less profitable outcomes for shareholders, and are more susceptible to promoting interests that best serve their own interests, be that ideological biases or in favor of current or potential clients.⁸⁴

77. Li, *supra* note 70, at app. A (finding evidence that may support an ISS preference toward its corporate management consulting clients in voting).

78. *Id.* at 2962.

79. Fenn, *supra* note 33.

80. Li, *supra* note 70, at app. A.

81. *Policies and Procedures for Managing and Disclosing Conflicts of Interest*, GLASS LEWIS (Mar. 29, 2021), <https://www.glasslewis.com/wp-content/uploads/2019/05/GL-Policies-and-Procedures-for-Managing-and-Disclosing-Conflicts-of-Interest-050819-FINAL.pdf>.

82. *Creating Controversy in Proxy Voting Advice*, *supra* note 44.

83. *Id.*

84. See Nicholas Donatiello & Harvey L. Pitt, *Protecting Shareholders from Activist Proxies: The SEC needs to put more teeth in its guidance and clarify its standards*, WALL ST. J., (May 28, 2015, 8:41 PM), <https://www.wsj.com/articles/protecting-shareholders-from-activist-proxies-1432860067>.

3. Transparency and Material Errors: Secret Processes and Differences of Opinion

While ISS publishes its baseline voting guidelines⁸⁵ and Glass Lewis has sample Proxy Paper® reports on its site,⁸⁶ the detailed process by which they and other PVABs generate their recommendations is largely secretive.⁸⁷ Corporate issuers have historically taken issue with the fact that they are unable to dispute recommendations, as well as the process by which they are crafted.⁸⁸ Corporate issuers typically fear a “one-size-fits-all” approach which doesn’t include the particularities of their own business.⁸⁹

Critics also object to the accuracy or completeness of the data by which PVABs evaluate proposals and make recommendations.⁹⁰ However, all three of the major PVABs, ISS, Glass Lewis, and Egan-Jones, prior to the amendments had some mechanism in place to receive feedback from corporate issuers on the substance of their recommendations or the factual basis upon which they were made.⁹¹

85. *Gateway Voting Policies*, INSTITUTIONAL S’HOLDER SERV., <https://www.issgovernance.com/policy-gateway/voting-policies/> (last visited Feb. 22, 2022).

86. *Proxy Paper Samples*, GLASS LEWIS, <https://www.glasslewis.com/sample-proxy-papers/> (last visited Dec. 7, 2020).

87. The general process by which ISS develops its guidelines is known, but the means by which they internally establish the guidelines is not. Brian Tayan, David Larcker, & James Copland, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 14, 2018) <https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/>.

88. GAO Report, *supra* note 34 (corporate issuers wish to have access to the reports on them prior to issuance, and as of 2017 both ISS and Glass Lewis had processes to provide access in some capacity).

89. Fenn, *supra* note 33; GAO Report, *supra* note 34. According to Tom Quaadman: One-size-fits-all recommendations, or overly broad “benchmark” policies developed by proxy advisory firms, cannot reflect the unique characteristics of individual issuers, and thus ultimately impair the quality of information that informs proxy voting decisions. A shareholder that trusts a fiduciary is not asking for “consistent” voting, but responsible voting that takes into account company-specific factors that will drive returns. The National Association of Manufacturers, Comment Letter on File No. 4-725: SEC Staff Roundtable on the Proxy Process (Oct. 30, 2018), at 2, <https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf> [<https://perma.cc/638M-JRZY>].

90. Concept Release, *supra* note 51. ISS responded to such accusations in 2018 stating that the complaints about the accuracy are overblown with minimal material errors and any dispute of the accuracy of ISS’s reports come from differences of opinion between them and the companies. *See* Letter from Gary Retelny, Pres. And CEO of Institutional Shareholder Services, to Brent J. Fields, Sec’y, SEC (Aug. 7, 2018) (on file with recipient).

91. *See* 2020 Final Rules, *supra* note 2. (ISS may provide corporate issuers the right to review aspects of their research reports for factual accuracy and maintains a filing process to track any changes made as a result of the review process. Glass Lewis provides a “Issuer Data Report” and established a newer “Report Feedback Statement” service which both allow corrective and suggestive feedback by corporate issuers. Egan-Jones has a variety of methods by which corporate issuers may assess and identify errors for Egan-Jones to correct).

II. THE INITIAL PROPOSAL

A. RULE 14 OF THE EXCHANGE ACT

The authority to regulate the proxy solicitation process was vested in the SEC by Congress in the Exchange Act.⁹² The Proxy Rules governing the solicitation of proxies are within Rules 14a-b.⁹³ The rules apply to all reporting companies that solicit proxies from their shareholders to vote on management and shareholder proposals up for vote at annual shareholder meetings.⁹⁴ As stated in Section I.C of this Note, PVABs were not originally subject to the Proxy Rules, although the SEC has long-held that the recommendations of PVABs constitute solicitations.⁹⁵

B. THE SEC PROPOSAL OF NOVEMBER 2019

In November of 2019, the SEC issued the Proposed Rules for Proxy Voting Advice (the 2019 Proposed Rules) seeking to adjust its framework regulating proxy solicitations for the purpose of “ensur[ing] that investors who use proxy voting advice receive more accurate, transparent, and complete information on which to make their voting decisions, in a manner that does not impose undue costs or delays that could adversely affect the timely provision of proxy voting advice.”⁹⁶

The 2019 Proposed Rules put forth major changes to Rule 14a of the Exchange Act, including: (i) amending the definition of “solicitation” to specifically include proxy voting recommendations, thus codifying the long-standing view of the SEC; (ii) implementing three requirements for PVABs to rely upon the traditional exemptions for avoiding the filing and information requirements of the Proxy Rules including tailored disclosures conflicts of interest, a time-limited commentary period for corporate issuers to review the recommendations accompanied by a mandatory and time-restricted final notice of advice, and a direct electronic hyperlink to any corporate issuer responses provided alongside the voting advice; and (iii) a modification of the anti-fraud provision of the Proxy Rules so that PVABs are explicitly liable for misleading misstatements or omissions.⁹⁷

92. *Id.*

93. Securities Exchange Act of 1934, 17 C.F.R. §§ 240.14a-1—14b-2 (2021).

94. Annual Meetings and Proxy Requirements, U.S. SEC. & EXCH. COMMISSION, <https://www.sec.gov/smallbusiness/goingpublic/annualmeetings>.

95. Concept Release, *supra* note 51 (At II(D)(5) this is advertised as a longstanding view of the SEC); *See* 2020 Final Rules, *supra* note 2 (citing to two SEC releases from 1964 and 1979 which define PVAB advice as solicitations).

96. *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518, at 1 (Nov. 5, 2019) [hereinafter 2019 Proposed Rules].

97. *Id.*; Brian V. Breheny et al., *SEC Proposes Amendments to the Proxy Rules Regarding Shareholder Proposals and Proxy Voting Advice*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Nov. 7, 2019), <https://www.skadden.com/insights/publications/2019/11/sec-proposes-amendments>.

C. THE INITIAL FEEDBACK

What was likely the most highly-contested aspect of the 2019 Proposed Rules was the requirement for “a review process allowing issuers an opportunity to comment on advice before its dissemination.”⁹⁸ This requirement would have had PVABs provide any corporate issuer whose proposals it issued recommendations regarding an opportunity to review and return commentary on a draft of the advice before it is sent to shareholders.⁹⁹ PVABS would then have had to give those corporate issuers notice and a copy of the final advice before finally distributing the recommendations to investors.¹⁰⁰

On the one hand, some small financial advisors,¹⁰¹ law firm partners,¹⁰² and individual investors, who had negative views overall of the role PVABs play in the voting process, supported the intense requirements included in the proposal.¹⁰³ Advocates generally echoed the problems outlined in Section I.E of this Note above. One individual even directly accused PVABs of furthering their own ESG agendas rather than maximizing shareholder returns.¹⁰⁴

On the other hand, there was backlash from PVABs and specialty funds alike. Both ISS and Glass Lewis fervently objected to the proposals, marking them as an attempt by the SEC to suppress shareholder participation¹⁰⁵ and

98. Arthur Don & Vincent Lewis, *The SEC's 2020 Amendments to Proxy Rules and Supplemental Guidance to Investment Advisers on Proxy Voting Responsibilities*, NAT'L L. REV. (Aug. 3, 2020), [https://www.natlawreview.com/article/sec-s-2020-amendments-to-proxy-rules-and-supplemental-guidance-to-investment#:~:text=Most%20importantly%2C%20the%20new%20rules,ii\)%20public%20disclosure%20of%20written](https://www.natlawreview.com/article/sec-s-2020-amendments-to-proxy-rules-and-supplemental-guidance-to-investment#:~:text=Most%20importantly%2C%20the%20new%20rules,ii)%20public%20disclosure%20of%20written).

99. Era Anagosti et al., *SEC Proposes Rule Amendments to Enhance Regulation of Proxy Advisers*, WHITE & CASE LLP (Nov. 21, 2019), <https://www.whitecase.com/publications/alert/sec-proposes-rule-amendments-enhance-regulation-proxy-advisers>.

100. *Id.* Copies would have to be given at least two days before distributing to investors. This would also be accompanied by additional filing burdens on PVABs.

101. Letter from anonymous AIG financial advisor, to Jay Clayton, Chairman, SEC (Jan. 3, 2020) (on file with the U.S. Sec. & Exchange Comm'n) (many other letters, including this one, protested a perceived political motivation of the liberal “left” in the proposed changes, even though the Commission voted in favor along a 3-1 republican appointed majority).

102. Letter from Paul J. Foley, Partner, Akerman LLP, to Jay Clayton, Chairman, SEC (Dec. 23, 2019) (on file with the U.S. Sec. & Exchange Comm'n).

103. Letter from Ohio Pensioner, to Jay Clayton, Chairman, SEC (Jan. 15, 2020) (on file with the U.S. Sec. & Exch. Comm'n); Letter from Brennan Clegg, to Jay Clayton, Chairman, SEC (Jan. 15, 2020) (on file with the U.S. Sec. & Exch. Comm'n) An interesting dynamic to note is that the large organizations that advocate for pension funds were not in support of the amendments, citing the value of the recommendations to them and rejecting the claims of automatic voting, whereas the individual members of those pension funds were mostly concerned that their pension funds participated in robo-voting and preferred what they felt would be a reduction in PVAB power over investors.

104. Letter from Lisa Lehman, to Vanessa Countryman, Sec'y, SEC (Jan. 6, 2020) (on file with the U.S. Sec. & Exch. Comm'n).

105. Letter from Gary Retelny, President and CEO, Institutional S'holder Serv., to Vanessa Countryman, Sec'y, SEC (Jan. 31, 2020) (on file with the U.S. Sec. & Exch. Comm'n).

as overall harmful to investor engagement.¹⁰⁶ In its comment letter to the SEC, Glass Lewis asserted that the “two-stage issuer review and feedback procedure” would severely impair PVAB’s ability to provide timely and independent recommendations—especially due to the seasonal nature of proxy voting.¹⁰⁷ ISS criticized this aspect of the proposals as violative of the constitutional First Amendment right to free speech.¹⁰⁸ ISS also filed suit against the SEC and Chairman Jay Clayton in the District Court of the District of Columbia, discussed in detail in Section III.C of this Note below.¹⁰⁹ Many others rebuked the proposals including organizations representing pension funds,¹¹⁰ SRI investors,¹¹¹ faith investors,¹¹² and government representatives.¹¹³ Socially responsible and ESG-oriented organizations and individuals also voiced their objections to the 2019 Proposed Rules.¹¹⁴

Other general complaints about the 2020 Final Rules included: that the SEC had no evidence of sufficient error or deficiencies to justify such additional requirements; that clients of PVABs were not the ones complaining but those on the receiving end of the recommendations; and the new requirements and disclosures would increase the burden and expense of delivering the recommendations and thus increase costs, decrease market competition, and impede on client’s time to digest the PVAB advice and potentially their ability to make timely voting decisions.¹¹⁵ There was also concern that such regulation will dilute the already-thin market for PVABs and voting recommendations, inadvertently decreasing availability of information.¹¹⁶ The greatest and most serious concern seemed to be a fear that the mandated commentary period by corporate issuers would reduce the independence, objectivity, and honesty of recommendations for fear of retributive litigation.¹¹⁷

106. Letter from Kevin Cameron, Exec. Chair, Glass Lewis, to Vanessa Countryman, Sec’y, SEC (Feb. 3, 2020) (on file with the U.S. Sec. & Exch. Comm’n).

107. *Id.*

108. Letter from Gary Retelny, *supra* note 105.

109. *See* Section II.E.3.

110. Letter from Hank Kim, Exec. Director & Counsel, Nat’l Conference on Pub. Employee Retirement Sys., to Jay Clayton, Chairman, SEC (Feb. 3, 2020) (on file with the U.S. Sec. & Exch. Comm’n).

111. Letter from Lisa Woll, CEO, US SIF, to Vanessa Countryman, Sec’y, SEC (Jan. 31, 2020) (on file with the U.S. Sec. & Exch. Comm’n).

112. Letter from Claire Deroche, Social Justice Coordinator, Unitarian Universalist, to Jay Clayton, Chairman, SEC (Jan. 29, 2020) (on file with the U.S. Sec. & Exch. Comm’n).

113. Letter from Bill Foster et al., Representatives, U.S. Cong., to Jay Clayton, Chairman, SEC (Jan. 31, 2020) (on file with the U.S. Sec. & Exch. Comm’n).

114. 2020 Final Rules, *supra* note 2.

115. *See id.*

116. *See id.* at Section IV.D.1-3.

117. *See id.*

III. THE NEW FRAMEWORK

The SEC released its ultimate framework in July of 2020, meticulously addressing the proposals, the comments from supporters and opponents, and the final amendments it chose to adopt.¹¹⁸ The revised rules became effective on November 2, 2020.¹¹⁹

A. THE ADOPTED CHANGES

The SEC, making minimal adjustments, purported to take a more “principles-based approach” in its amendments, following the principle that “more complete and robust information and discussion” will facilitate knowledgeable investor actions and is therefore a value which prioritizes investor’s interests.¹²⁰ The SEC also provided PVABs with guidance on what it considers compliance with the new requirements in two non-exclusive safe harbors.¹²¹

1. PVAB Recommendations are Solicitations

The addition of paragraph (A) to Rule 14(a)-1(l)(1)(iii), the definition section, explicitly ropes PVABs into the schema governing solicitations.¹²² This codifies the SEC’s long-held opinion that PVAB recommendations have constituted solicitations under Rule 14(a).¹²³

In the 2020 Final Rules, the SEC specifically addresses the primary allegation in the ISS Complaint, that the amendments exceed the authority granted to the SEC under the Exchange Act.¹²⁴ The SEC rejects this argument, reading its authority narrowly, and asserts it has a broad power to, essentially, regulate anything touching proxy solicitations.¹²⁵

2. Preconditions to Filing Exemptions

The addition of paragraph (v) under Rule 14(a)-1(l)(2) codified the idea that the Proxy Rules would not apply to any proxy voting advice “furnished

118. See 2020 Final Rules, *supra* note 2. The SEC also issued “supplementary guidance regarding the proxy voting responsibilities of investment advisers” under the Advisers Act, discussing how advisers should interpret any corporate issuer response to PVAB recommendations, specifically robo-voting, and reiterating the duties of advisers. See Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5547 (July 22, 2020).

119. *Id.*

120. See *id.*

121. 2020 Final Rules Press Release, *supra* note 1. A safe harbor provision is one which exempts a party from legal liability or obligation, provided certain conditions are met. Adam Hayes, *Safe Harbor*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/safeharbor.asp> (last visited Feb. 22, 2022).

122. See 2020 Final Rules, *supra* note 2; 17 C.F.R. § 240.14(a)-1(l)(iii) (2020).

123. 2020 Final Rules Press Release, *supra* note 1.

124. See 2020 Final Rules, *supra* note 2; Complaint at 20, Institutional S’holder Servs. Inc., v. Securities and Exchange Commission and Walter Clayton III, (Oct. 31, 2019).

125. See 2020 Final Rules, *supra* note 2.

by a person who furnishes such advice only in response to an unprompted request.”¹²⁶

The exemptions from disclosure and filing requirements of the Proxy Rules in Rule 14(a)-2(b)(1) and (b)(3) can only be utilized by PVABs upon their satisfaction of the new Rules 14a-2(b)(9)(i) and 14a-2(b)(9)(ii).¹²⁷ Subpart (i) requires that, to qualify for the exemptions, PVABs provide specific disclosures of conflicts of interest with recommendations.¹²⁸ Subpart (ii) mandates that PVABs adopt and disclose their policies and procedures, which must guarantee that corporate issuers have access to those recommendations before or at the same time it is presented to the PVAB clients, and that the clients are provided with a mechanism which is reasonably likely to make them aware of any responses the subjects of recommendations have made.¹²⁹

3. PVAB Recommendations are Subject to Fraud Liability

The addition of Note (e) to Rule 14a-9 provided: “the failure to disclose material information regarding proxy voting advice, ‘such as the proxy voting advice business’s methodology, sources of information, or conflicts of interest’ could, depending upon particular facts and circumstances, be misleading within the meaning of the rule.”¹³⁰ The SEC further specified that the purpose of the edition was to provide clarity and to reinforce that PVAB recommendations are subject to the anti-fraud requirement.¹³¹

Summarized, the 2020 Final Rules enforce four major changes: (1) the PVAB recommendations are officially “solicitations” and subject to the Proxy Rules; (2) there are new conflict of interest disclosure requirements; (3) corporate issuers now have access to and may provide input on the recommendations *at the time* they are provided to clients; and (4) PVABs are (still) subject to liability under the Proxy Rules for materially misleading statements or omissions.¹³²

The greatest difference between the 2019 Proposed Rules and the 2020 Final Rules is that PVABs will not have to provide corporate issuers with the opportunity to review recommendations or provide input prior to their

126. *See id.* This decision is significant because it protects persons that neither sell voting advice as a business, nor hold themselves out to do so, in responding to unprompted requests for advice from clients purchasing other services. The SEC considers this sufficient because such voting advice normally does not pose the same concerns as PVABs selling advice because they are less likely, if at all, to market themselves on their proxy voting advice and therefore require no regulation.

127. *See* 2020 Final Rules, *supra* note 2.

128. *Id.*

129. 2020 Final Rules Press Release, *supra* note 1.

130. *Id.*

131. *See* 2020 Final Rules, *supra* note 2.

132. *See id.*

publication to clients.¹³³ PVABs will only need to provide a means of accessing corporate issuer responses to clients.¹³⁴ Therefore, corporate issuers will still be able to provide additional information as a supplement to PVAB recommendations, creating more robust and accurate information available, and will be able to respond prior to the annual shareholder meeting.¹³⁵ Another significant change is that PVABs will now officially need to include in-depth conflict of interest disclosures in their recommendation materials.¹³⁶

B. RESPONSES FROM THE PUBLIC

Many organizations and individuals publicly voiced their disapproval after the final adoption. For example, US SIF: Forum for Sustainable and Responsible Investment released a statement voicing disapproval of the new amendments, asserting that a valuable independent resource for recommendations has been compromised and that power has shifted back into the hands of corporate management.¹³⁷ Public Citizen, a popular nonprofit consumer advocacy organization, urged then President-elect Biden to support revising the 2020 Final Rules as part of their recommended transition agenda.¹³⁸ Early on, in December of 2020, Chairwoman of the House Financial Services Committee, Representative Maxine Waters, released a statement beseeching President-elect Biden to reverse the 2020 Final Rules, among other SEC regulation promulgated under Chairman Clayton.¹³⁹ The addition of Note (e) to Rule 14a-9 was also widely criticized as placing a heightened burden of disclosure on PVABs, for fear that any omitted information could be deemed “material” enough to inspire litigation by issuers.¹⁴⁰

133. David Bell et al., *SEC Tightens Regulations on Proxy Advisory Firms*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 18, 2020), <https://corpgov.law.harvard.edu/2020/08/18/sec-tightens-regulations-on-proxy-advisory-firms/>.

134. *Id.*

135. Aileen Bonaface & Jeremy Apple, *What the New SEC Proxy Rules Mean*, CLERMONT PARTNERS (Sept. 16, 2020), <https://www.clermontpartners.com/blog/what-the-new-sec-proxy-rules-mean/>.

136. Bell et al., *supra* note 133.

137. *US SIF Releases Statement on SEC Vote to Regulate Proxy Advisory Firms*, US SIF (July 30, 2020), https://www.ussif.org/blog_home.asp?display=146.

138. Letter from Public Citizen to Biden Transition Team, *Actions the Next Administration Can Take to Address Financialization* (Oct. 2020) <https://www.citizen.org/wp-content/uploads/Financial-Reform-Transition-Memo-Public-Citizen.pdf>.

139. Caitlin Reilly & CQ Roll Call, *Waters Urges Biden to Reverse SEC Proxy, Shareholder Rules*, WESTLAW (Dec. 8, 2020), 2020 WL 7222368.

140. See U.S. Sec. & Exch. Comm'n, Fact Sheet Proxy Voting Advice at 2, <https://www.sec.gov/files/34-93595-fact-sheet.pdf>.

C. ISS SUES THE SEC

In October of 2019, after the SEC issued its initial guidance and solicited commentary, ISS filed suit in District of Columbia U.S. District Court against the SEC.¹⁴¹ The suit, *Institutional Shareholder Services, Inc., v. Securities and Exchange Commission et al*, initially alleged, among other things, that the SEC proposed amendments were (1) unlawful because they exceed the SEC's statutory authority of the Exchange Act by attempting to classify proxy advice as a "solicitation" and (2) are arbitrary and capricious as ISS is sufficiently regulated under the Investment Advisers Act of 1940 (Advisers Act).¹⁴²

After pausing the suit in early 2020 to permit the SEC to amend and finalize its regulations,¹⁴³ ISS resumed litigation, insisting that, "the solicitation of a proxy and the provision of proxy advice are fundamentally different activities."¹⁴⁴

The suit is currently in abeyance, as the SEC filed a motion in June of 2021 to suspend the litigation¹⁴⁵ after Chairman Garry Gensler and the Division of Corporation Finance issued statements that the SEC would not be enforcing, but instead would be reconsidering the 2020 Final Rules.¹⁴⁶ The District Court, on January 4, 2022, issued an order further staying the case until either the end of March of 2022, or the finalization of the 2022 Proposed Rules.¹⁴⁷

D. OTHER PVABS REACT

In what seemed to be a preemptive strike, Glass Lewis announced in April of 2020, prior to the SEC's July publication of the 2020 Final Rules, that it would be providing company feedback on its research along with initial

141. The suit was initially filed against Walter "Jay" Clayton III, then-Chairman of the SEC; current Chairman Gary Gensler is now the second named defendant. Steven Friedman, *The Basis for ISS' Lawsuit Against the SEC*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 5, 2019), <https://corpgov.law.harvard.edu/2019/11/05/the-basis-for-iss-lawsuit-against-the-sec/>.

142. Complaint at 2, *Institutional S'holder Servs. Inc., v. SEC*, (Oct. 31, 2019) <https://www.issgovernance.com/file/duediligence/iss-oct-31-2019-complaint.pdf>

143. Svea Herbst-Bayliss, *Proxy Adviser ISS to Push Ahead with Lawsuit against SEC over New Rule*, THOMPSON REUTERS (Aug. 13, 2020), <https://www.reuters.com/article/us-iss-sec/proxy-adviser-iss-to-push-ahead-with-lawsuit-against-sec-over-new-rule-idUSKCN25934B>.

144. Friedman, *supra* note 141.

145. See Andrew Ramonas, *SEC, ISS Move to Freeze Proxy Adviser's Suit on Trump-era Rules*, BLOOMBERG LAW (June 2, 2021) <https://news.bloomberglaw.com/securities-law/sec-iss-move-to-freeze-proxy-advisers-suit-on-trump-era-rules>.

146. Statement, U.S. Sec. & Exch. Comm'n Div. of Corp. Fin., *Statement on Compliance with the Commission's 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9* (June 1, 2021); Ramonas, *supra* note 145.

147. Bill Flook, *Court Maintains Pause in Proxy Firm Suit*, 16 WGL-ACCTALERT 3 (Jan. 5, 2022).

reports provided to its clients.¹⁴⁸ After the 2020 Final Rules were adopted, Egan-Jones issued a confident statement that their business would not be adversely impacted by the new regulations, primarily because they do not offer any services aside from their recommendations.¹⁴⁹

E. THE SEC'S WALKBACK

The political conversation surrounding the 2020 Final Rules has, in some ways, served as a proxy fight over the increasingly partisan nature of the SEC and the administrative state itself. At its conception and historically, the SEC has been an independent agency—ideally insulated from influence by the Executive branch—which provides stable and objective guidance over the securities industry.¹⁵⁰ Recently, appointments to the Commission have been motivated more by partisan loyalty than objective qualification. This has led to rules, much like the 2020 Final Rules at hand, passing 3-2 along ideological lines rather than with the full or near-full support of the Commission.¹⁵¹ The 2020 Final Rules are perfectly situated to be at the center of this push-and-pull; former SEC Chair Clayton (Republican) was known to be an industry-friendly regulator, pushing minimal oversight.¹⁵² The new Chairman Gensler (Democrat), on the other hand, is branded as a progressive, demanding overseer who emphasizes disclosure and investor-oriented regulation.¹⁵³ The pendulum is already swinging towards increasing monitoring.

F. SUBSEQUENT SEC ACTION

Recent SEC action on PVAB rules bodes well for those opposed to the 2020 Final Rules; in June of 2021, the Division of Corporation Finance released a statement that, at the direction of Chairman Gensler, it would be, “considering whether to recommend that the Commission revisit the 2019 Interpretation and Guidance and the 2020 Rule Amendments.”¹⁵⁴ In November of 2021, the Commission voted to publish the 2021 Proposed Rule

148. Press Release, Glass Lewis, Glass Lewis Announces that Company Opinions are Now Included with Research and Voting Recommendations (Apr. 2, 2020).

149. Press Release, Egan-Jones, Egan-Jones Proxy Statement on New SEC Proxy Firm Rules (July 23, 2020).

150. Roberta S. Karmel, *Little Power Struggles Everywhere: Attacks on the Administrative State at the Securities and Exchange Commission*, 72 ADMIN. L. REV. 207, 242 (2020).

151. The Commission is composed of five commissioners, and no more than three commissioners may be from the President's party. “Although they may have had differences of opinion... these disagreements were not necessarily partisan. In recent years, however, appointments of Democratic and Republican commissioners have been paired and many commissioners have had a background as staffers in congressional committees with SEC oversight.” *Id.* at 242–243.

152. See Kellie Mejdrich, *Gensler clashed with SEC investor-advice rule in sign of changes to come at regulator*, POLITICO (Jan. 25, 2021, 12:35 PM) <https://www.politico.com/news/2021/01/25/gensler-sec-changes-462251>.

153. See *id.*

154. Corporation Finance Statement on Compliance, *supra* note 146.

Amendments, which would rescind the most contentious provisions of the 2020 Final Rules due to concerns over the heightened cost/time burden and litigation risk.¹⁵⁵ Specifically, the rescission would delete the two preconditions that require PVABs to receive and then provide issuer input to clients, as well as Rule 14(a)-9 Note (e) which specifically calls out PVABs as liable for material misstatements or omissions.¹⁵⁶ The Trump-appointed, Republican Commissioners Elad Roisman and Hester Peirce issued responsive statements to both, disagreeing with the actions taken.¹⁵⁷ No official adoption has been made as of the time of this writing.

IV. SPECIALTY VOTING AND THE RELIANCE ON PVABS

Informed voting is a fundamental element of efficient voting in corporate governance.¹⁵⁸ While it is not the only element of voting efficiently or correctly,¹⁵⁹ it is the bare minimum approach in doing so. As emphasized in Section I.D of this Note, “the act of voting, and becoming informed enough to vote intelligently, requires an investment of time, which is a scarce resource.”¹⁶⁰

The SEC, in November of 2021, adopted amendments to another portion of the proxy rules which enhances the ability of shareholders to elect directors in proxy contests, further pushing the regulatory scheme in a direction which welcomes active participation by shareholders.¹⁶¹

155. 2021 Proposed Rules Press Release, *supra* note 7; 2021 Proposed Rules, *supra* note 5.

156. Lucas F. Torres & Kimia Jalalipour, *SEC Proposed Amendments to July 2020 Rules Governing Proxy Advisors and Proxy Voting Advice Businesses*, AKIN GUMP STRAUSS HAUER & FELD LLP (Dec. 20, 2021) <https://www.akingump.com/en/experience/practices/corporate/ag-deal-diary/sec-proposes-amendments-to-july-2020-rules-governing-proxy-advisors-and-proxy-voting-advice-businesses.html>.

157. Statement, Elad L. Roisman & Hester M. Peirce, Commissioners, U.S. Sec. & Exch. Comm’n, Response to Chair Gensler’s and the Division of Corporation Finance’s Statements Regarding the Application of the Proxy Rules to Proxy Voting Advice (June 1, 2021) (on file with the SEC); Statement, Elad L. Roisman, Commissioner, U.S. Sec. & Exch. Comm’n, Too Important to Regulate? Rolling Back Investor Protections on Proxy Voting Advice (Nov. 17, 2021) (on file with the SEC); Statement, Hester M. Peirce, Commissioner, U.S. Sec. & Exch. Comm’n, Dissenting Statement on Proxy Voting Advice Proposal (Nov. 17, 2021) (on file with the SEC).

158. Michael C. Schouten, *The Mechanisms of Voting Efficiency*, 2010 COLUM. BUS. L. REV. 763 (2010) (stating that the general consensus is that informed voting is sufficient to characterize voting as efficient and that efficient voting is a balance of four mechanisms).

159. *Id.* (“(1) informed voting, which implies that shareholders have some information upon which to base their voting decisions; (2) rational voting, which implies that such information is processed in a rational, unbiased way; (3) independent voting, which implies that each shareholder arrives at a judgment by making use of his or her personal cognitive skills; and (4) sincere voting, which implies that shareholders vote with a view to furthering the common interest of maximizing shareholder value rather than their own private interests”).

160. Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990).

161. Eric J. Belfi, Lara Goldstone & Phillip J. Leggio, *Investor Alert: SEC’s Universal Proxy Rules Benefit Shareholders*, LABATON SUCHAROW (Dec. 3, 2021) <https://www.labaton.com/blog/secs-universal-proxy-rules-benefit-shareholders>.

A. SPECIALTY VOTING

There are many funds that tailor their investments according to certain principles. These specialty, or “sector,” funds incur a higher risk as they tend to be less diversified¹⁶² and allow investors to target a specific market sector such as energy, health care, real estate, or technology.¹⁶³ The investment in sector funds generally has the same goal as most others—to be profitable.¹⁶⁴ Specialized and targeted investment strategies are not uncommon. However, along with the emerging social consciousness of shareholders in the modern era, comes the rise of “ethical funds.”¹⁶⁵ These sustainable “virtue funds” and Socially Responsible Investment (SRI) funds exclusively invest in companies which align with environmentally responsible practices or objectives or maintain viewpoints which align with progressive socially-conscious values.¹⁶⁶ A subset of these sustainable funds are those which represent themselves as ESG funds.¹⁶⁷ While there is not one standardized method, ESG can be described as “an investment strategy that incorporates the environmental, social, and governance practices of investee firms in portfolio composition and management.”¹⁶⁸ (For all intents and purposes, ESG is similar enough to be lumped in with sustainable principles here.)¹⁶⁹ It follows that funds with these objectives carry such perspectives into their voting.¹⁷⁰

1. The Rise of ESG

Many ESG and specialty funds originated as a subset of conscious investors who sought to break away from the traditional method of investment strategy. The past decade has seen a boom of ESG and sustainable funds—as of 2019, more than 300 funds managed over \$20 billion in assets in the U.S., with global ESG funds managing \$30 trillion in assets.¹⁷¹ Due to a variety of factors, including the appeal of a combination-investment

162. *Vanguard Sector & Specialty Funds*, VANGUARD, <https://investor.vanguard.com/mutual-funds/sector-specialty> (last visited Nov. 10, 2020).

163. Brian D. Fitzpatrick, Joshua Church & Christopher H. Hasse, *Specialty Funds vs. General Mutual Funds and Socially Responsible Investment (SRI) Funds: An Intriguing Risk/Return Paradigm*, 13(2) J. OF APP. BUS. & ECON. 175 (2012).

164. *See id.*

165. *Id.* at 179.

166. *Id.*

167. Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1923 (2020).

168. *Id.* at 1926, 1922.

169. *See* Michelle Zhou, *ESG, SRI, and Impact Investing: What's the Difference?*, INVESTOPEDIA <https://www.investopedia.com/financial-advisor/esg-sri-impact-investing-explaining-difference-clients/> (Aug. 22, 2019).

170. The author acknowledges that ESG is currently an unstandardized investment strategy; Brakman Reiser & Tucker, *supra* note 167 at 1965. Here, authors Brakman Reiser and Tucker included in their ESG voting survey funds which more aptly can be described as “faith-based.”

171. *Id.* at 1922.

approach which mixes long-term profits with social responsibility, ESG funds weaponize an attractive strategy.¹⁷² Many large asset managers, such as the Big Three, have established their own separate ESG funds which seek to advocate for SRI principles.¹⁷³ In January of 2020, Larry Fink, Chairman and CEO of the industry-leading asset management firm BlackRock, announced in his annual letter to CEOs of companies in which BlackRock is invested that future investment decisions by the firm would be made with sustainability at their core and called for an improved disclosure framework.¹⁷⁴ As BlackRock calls for more thorough disclosures from companies, it also calls for more transparency from PVABs.¹⁷⁵

2. ESG Voting Habits

Independent ESG funds reliably vote in favor of proposals that align with ESG principles, even if doing so runs against the traditional fiduciary duty to maximize capital returns.¹⁷⁶ However, it turns out that the largest asset managers may not be acting as advertised when voting for their specialty funds.¹⁷⁷ Particularly, ESG-labeled funds from Vanguard,¹⁷⁸ BlackRock, and other large traditional investors in 2019 essentially voted in conflict with an ESG perspective, and more in alignment with their parent organizations' viewpoints.¹⁷⁹ This is problematic because investors place their money in these funds specifically for the purpose of specialty investing and voting. Investment advisers are entitled to use PVAB voting recommendations so long as the policy guidelines for those recommendations are "designed to further the interests of the client rather than the adviser."¹⁸⁰ Where we are able to enforce greater transparency, we should.

172. *Id.* at 1925.

173. Caleb N. Griffin, *Environmental and Social Voting at the Big Three*, CLS BLUESKY BLOG (June 16, 2020), <https://clsbluesky.law.columbia.edu/2020/06/16/environmental-and-social-voting-at-the-big-three/>.

174. Larry Fink, *A Fundamental Reshaping of Finance*, BLACKROCK ADVISOR CTR., <https://www.blackrock.com/us/financial-professionals/larry-fink-ceo-letter> (last visited on Nov. 10, 2020).

175. Letter from Barbara Novick and Ray Cameron, Vice Chairman and Managing Director, BlackRock, Inc., to Brent J. Fields, Sec'y, SEC (Nov. 16, 2018) (on file with BlackRock, Inc.) ("[W]e think that some improvements to transparency would benefit all stakeholders... [and would] be consistent with our collective desire to enhance the quality of proxy process research and promote competition within the industry").

176. Brakman Reiser & Tucker, *supra* note 167 at 1959.

177. Griffin, *supra* note 173.

178. Brakman Reiser & Tucker, *supra* note 167 at 1958 (showing that Vanguard's FTSE Social Index Fund specifically opposed every pro-ESG proposal it voted on).

179. James McRitchie, *Morningstar Direct Uncovers ESG Hypocrites*, CORPGOV.NET (Mar. 20, 2019), <https://www.corpgov.net/2019/03/morningstar-direct-uncovers-esg-hypocrites/> (stating that in contrast to long-term ESG focused funds which voted consistently with such principles. The article also notes that the portfolios of the traditional investors contain unsustainable energy investments, as opposed to the long-term ESG funds which lack these antithetical investments).

180. See INTECH Investment Management LLC, Investment Advisers Act Release No. 2872, 95 SEC Docket 2265 (May 7, 2009).

B. PVABS AND SPECIALTY VOTING

While PVAB recommendations are supposedly a case-by-case analysis of each proposal for each client, PVABs do publish baseline guides for their determinations. For example, though ISS issues each client individually-tailored recommendations, it also maintains a wide variety of proxy voting guideline examples which it publishes its website.¹⁸¹ The voting policies are generally tailored to global regions and countries, like Europe and the United States or Japan.¹⁸² ISS also advertises U.S. and international voting guidelines for special interests, including SRI policies, sustainability policies, and climate policies.¹⁸³ Glass Lewis similarly publishes its general voting guidelines¹⁸⁴ for each market it conducts analyses in, as well as ESG reports¹⁸⁵ and proxy season reviews to highlight trends and statistics in voting.¹⁸⁶

As raised in Section II, many who are in support of specialty and sustainable voting commented in opposition to the 2019 Proposed Rules.¹⁸⁷ It bears repeating that complaints chiefly centered around the perceived weakening of a source of independent information regarding material ESG issues. Another key commonality between these complaints points to an underlying distaste for the return of power to the hands of traditional company management. The fear of losing an independent resource to balance out the power of traditional company management overshadows the potential for the increased monitoring and transparency that can come of these amendments. As stated in Section II.E of this Note, though the adopted 2020 Final Rules excluded the requirement for direct corporate issuer participation in the process, funds were still unhappy with the attachment of any commentary by the corporate issuers.

181. Gateway Voting Policies, *supra* note 85.

182. *Id.*

183. ISS also has guidelines for Taft-Hartley policies, Public Fund policies, and Catholic Faith-Based policies. *Id.*; Press Release, Institutional Shareholder Services, Policy Supports Investors Choosing to Integrate Climate Performance & Disclosure into their Proxy Voting <https://www.iss.governance.com/iss-launches-climate-voting-policy/> (Mar. 9, 2020) (noting that ISS's climate policy is the most recent thematic specialty voting policy the PVAB added to its arsenal, only announced in March of 2020).

184. *Guidelines*, GLASS LEWIS, <https://www.glasslewis.com/guidelines/> (last visited Oct. 8, 2020).

185. *Special Reports*, GLASS LEWIS, <https://www.glasslewis.com/special-reports/> (last visited Oct. 8, 2020).

186. *Proxy Season Reviews*, GLASS LEWIS, <https://www.glasslewis.com/proxy-season-reviews/> (last visited Oct. 8, 2020).

187. *See* 2020 Final Rules, *supra* note 2.

C. PVABS AND ESG VOTING RECOMMENDATIONS

PVABs have shown a bias in their voting recommendations on executive compensation, labor union-supported proposals, and ESG matters,¹⁸⁸ all leaning toward a more progressive stance in support of such resolutions.¹⁸⁹ But even between PVABs there is disparity in voting recommendations on resolutions supporting ESG principles.¹⁹⁰ When it came to responsible investment resolutions in 2019, ISS encouraged a “for” vote nearly 79% of the time, compared to Glass Lewis’ 53% of the time.¹⁹¹ Concern here points in the direction opposite of the typical complaint about PVABs—that their recommendations in the realm of ESG are not being as strictly followed as they should be.¹⁹²

ISS released its annual benchmark survey in September of 2020, which supports an investor gravitation toward ESG-friendly preferences by shareholders.¹⁹³ A majority of its investor respondents felt that, where state law permits, boards should disclose the demographics of their members; shareholders also indicated a desire for heightened company reporting and addressing of climate change.¹⁹⁴ In a move spurred by the COVID-19 Pandemic, as well as the “social unrest” throughout the U.S. in mid-2020, ISS in November 2020 announced an update to its benchmark proxy voting policies: beginning in 2022, ISS will issue negative voting recommendations against U.S. corporate issuers with boards that lack ethnic or racial diversity.¹⁹⁵ Moreover, a mere five days later, ISS announced its acquisition by Deutsche Börse—essentially cementing its place as an ESG-oriented company, at clear odds with the general sentiment of U.S. investing strategies which place lesser weight on ESG and SRI voting.¹⁹⁶

A look at the 2021 proxy season reveals that environmental and social resolutions are still maintaining and even exceeding the support they received

188. James Glassman & J.W. Verret, *How to Fix Our Broken Proxy System*, MERCATUS CTR. AT GEO. MASON UNIV. (2013), https://www.mercatus.org/system/files/Glassman_ProxyAdvisorySystem_04152013.pdf.

189. Chuach et al., *supra* note 71 (supported by Findings 1 and 2).

190. *Id.* Acknowledging that ESG investing is an undefined and non-standardized investing strategy and using ESG as an example of specialty voting given its rising prominence as a strategy in recent years.

191. *Id.*

192. *Id.*

193. Press Release, INSTITUTIONAL S’HOLDER SERVICES, ISS Announces Results of Global Benchmark Policy Survey (Sept. 25, 2020).

194. *Id.*

195. Press Release, INSTITUTIONAL S’HOLDER SERVICES, ISS Announces 2021 Benchmark Policy Updates (Nov. 12, 2020); Era Anagnosti et al., *ISS Announces 2021 Benchmark Policy Updates*, WHITE & CASE LLP (Nov. 24, 2020), <https://www.whitecase.com/publications/alert/iss-announces-2021-benchmark-policy-updates>.

196. Deutsche Börse acquires leading governance, ESG data and analytics provider ISS, ISS GOVERNANCE, <https://www.issgovernance.com/deutsche-borse-acquires-leading-governance-esg-data-and-analytics-provider-iss/> (last visited Nov. 22, 2020).

in 2020.¹⁹⁷ While all ESG funds exercise those principles through selecting investments, or at least purport to, they also see shareholder capabilities as a means to further impute ESG changes within the structure of those companies—namely, through the ability to vote their shares.¹⁹⁸ This is where the importance of PVABs comes into play. Such funds have a fiduciary duty to vote in their clients' best interests which, if they are unable to personally analyze each proposal that should be voted on, necessarily gets passed through to an obligation to monitor the PVABs they employ.¹⁹⁹ Because there can be such a reliance on these PVABs in ESG investing, the additional rigor is beneficial to the flow and quality of information.

D. ESG INVESTING AND THE SEC

In his November 2020 address to the U.S. Senate, SEC Chairman Clayton said, “The principle that more complete and robust information and discussion leads to more informed investor decision-making, and therefore results in choices more closely aligned with investors’ interests, was a principal factor in the Commission’s adoption of these amendments.”²⁰⁰

In 2020 the SEC had an ESG subcommittee dedicated to, among other things, determining whether ESG is about values or value, and the considerations of proxy voting in ESG funds.²⁰¹ The subcommittee’s first report set up a discussion about the specific relationship between PVABs and ESG funds,²⁰² but its second report stated that the 2020 Final Rules, released in the months between the two reports “effectively improved investors ethical outcomes and in combination with rule 13F²⁰³ provide an adequate level of transparency with respect to proxy voting whether a fund is designed to include ESG considerations or not.”²⁰⁴ The subcommittee did, however, deem ESG issues to be “material” and stated that corporate issuers should disclose such information in a way that is comprehensive, meaningful, and

197. Hannah Orowitz & Brigid Rosati, *An Early Look at the 2020 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 10, 2020), <https://corpgov.law.harvard.edu/2020/06/10/an-early-look-at-the-2020-proxy-season/>; Shirley Westcott, Alliance Advisors, *2021 Proxy Season Review*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 5, 2021) <https://corpgov.law.harvard.edu/2021/08/05/2021-proxy-season-review/>.

198. Brakman Reiser & Tucker, *supra* note 167 at 1932.

199. *Id.* at 1970.

200. “Oversight of the Securities and Exchange Commission,” *supra* note 52.

201. ESG Subcommittee, *ESG Subcommittee Update*, U.S. SEC. & EXCH. COMM’N, (May 27, 2020), https://www.sec.gov/files/ESGSubcommitteeUpdate_0.pdf (explaining that the ESG Subcommittee serves under the Asset Management Advisory Committee).

202. The Subcommittee’s first report asked some crucial questions regarding the purpose and significance of ESG funds currently utilizing and voting with or against PVAB recommendations, and what the regulatory landscape for proxy voting should look like with respect to the booming realm of ESG. *Id.*

203. 17 C.F.R. § 240.13f-1.

204. ESG SUBCOMMITTEE, *Update on progress in ESG Subcommittee*, U.S. SEC. & EXCH. COMM’N (Sept. 16, 2020), <https://www.sec.gov/file/update-from-esg-subcommittee-09162020.pdf>

comparable.²⁰⁵ While at the time of this writing no further official actions have been taken, the SEC Investor Advisory Committee also recommended that ESG information should be regarded as material.²⁰⁶

V. SUPPLEMENTING THE PROXY RULES

Given the prominence of ESG funds, the fact that their popularity is only on the rise, and the fact that active ESG funds heavily rely on voting to effectuate their ideals, it is crucial that PVABs are regulated to best maximize ESG fund investments and activity.

This Note proposes that the new rules as they stand should be supplemented by the creation of an advisory review board under the SEC to directly and expeditiously handle complaints during the proxy season and to monitor the recommendation and voting process. One of the primary concerns of those opposed to the adoption of the 2020 Final Rules is that the independent source of information for specialty voting will be tainted by corporate issuer input pressure under threat of litigation.²⁰⁷ Author Tamara C. Belinfanti proposed a similar solution as one of three options to regulate and monitor PVABs in 2009, another being that the SEC develop its own regulatory framework.²⁰⁸ It is clear that a gap remains in the SEC's regulatory framework where there should be a stronger consideration for specialty funds. Thus, the addition of an advisory board, created by an additional amendment to the Proxy Rules, would sufficiently create a buffer between PVABs and corporate issuers.

However, while Belinfanti proposed an oversight board similar to the Public Company Accounting Oversight Board (PCAOB), the proper format for an advisory board that would function best is to create it as a subdivision within the Division of Corporation Finance. This way, it could more seamlessly handle disputes between corporate issuers and PVABs during Proxy Season. No autonomous independent oversight is needed since the 2020 Final Rules instituted a self-regulatory framework for PVABs to operate within, and the gap to be filled is borne of a tension between corporate issuers and the recommendations they find to be inaccurate but may be defended by PVABs as a difference of opinion. By removing the immediate threat of litigation and establishing a warning period for PVABs to correct recommendations or factual allegations that would potentially create liability

205. *Id.* Noting that required disclosures must be comprehensive and cover “all material ESG issues,” explore the issuer’s relationship to “each material” issue and be balanced against and standardized with other issuers across and within industries.

206. Allison Benington & Anne Sheehan, *Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 28, 2020).

207. See Section II.C; 2020 Final Rules, *supra* note 2 at 30.

208. Tamara C. Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 STAN. J.L. BUS. & FIN. 384 (2009) (the third suggestion Belinfanti made was to “re-examine mutual funds’ exercise of voting authority”).

for fraud, PVABs are less likely to provide less honest recommendations for fear of litigation, and corporate issuers are able to have their complaints expeditiously evaluated and corrected if necessary.

CONCLUSION

Ultimately, the success of these amendments depends on the happiness of specialty voting groups, predominantly ESG-oriented and SRI-focused funds. The combination of the rise of shareholder participation and the increasing desire for those shareholders to selectively invest and care about a variety of issues means that the free flow of information regarding such issues must be open and honest—transparent and accurate. Thus, the implementation of an advisory or review board to arbitrate disputes and mitigate the threat of litigation is best suited to ensure the success of the 2020 Final Rules and protect the livelihood of ESG funds and the sources of independent information they strongly rely on.

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