# SEC's Proxy Advisor Rule Should Be Finalized Despite Clayton's Potential Departure

**Ike Brannon** Contributor
Policy
*Ike Brannon is a senior fellow at the Jack Kemp Foundation*

SEC Chairman Jay Clayton has recently made more headlines than usual because of his controversial nomination to be the U.S. attorney for the Southern District of New York. The prospect of Clayton leaving the Commission led some to suggest that the fate of his rulemaking agenda—in particular a long-sought rule to enhance oversight of the activities of proxy advisory firms – was also in jeopardy. Fortunately, Clayton remains committed to his agenda, and recently confirmed that the rule will be issued in the next three months. Its issuance will represent a step in the right direction for investors large and small.

The perspective that proxy advisory firms have accreted too much power over the actions of their clients is not a recent development. The SEC's proposed rule is the product of years of study, public input, and stakeholder feedback. Given the yeoman's work that's been done on this issue, suggesting that the Commission hit pause on its work just when it is about to conclude makes little sense.



Proxy advisors play a critical role in the proxy process by advising investment managers—who manage funds that have stock in hundreds of different companies—on how they vote their proxy for each company. It would be costly and complicated for investment managers to individually review every issue they must vote for every stock they own each proxy season, so they enlist the help of proxy advisory firms to assist them.

However, it appears many investment managers do not perform due diligence over how those shares are actually voted, and some believe that this omission may breach their fiduciary duty to act in the best interest of their clients.



A paper recently published by Chong Shu, a scholar at USC, found that 23 percent of investment managers who use Institutional Shareholder Services (ISS) as their proxy adviser simply vote blindly with their recommendations, a practice known as robo-voting. This is consistent with past studies that have indicated that ISS can sway up to a quarter of a proxy vote after issuing a negative recommendation.

In addition to wielding significant power in proxy votes, proxy advisors are more likely to support controversial environmental and social shareholder resolutions than most large institutional investors. These proposals are often introduced by a small group of activist shareholders motivated by a political agenda, rather than the long-term viability of the company or its future performance. On these often contested, non-routine proposals, investment managers are particularly duty-bound to also review why the company opposes the resolution instead of automatically voting with the proxy advisor.



The SEC first broached the potential problems with proxy advisory firms back in 2010, during the Obama Administration, when it solicited comment on a concept release. In 2013, the SEC held its first roundtable on proxy advisory firms, indicating even back then the Commission perceived that the proxy advisors may impact the integrity of the proxy process.

Chairman Clayton's SEC led the development of this proposal, but only after a wide range of stakeholders called for the Commission to put this on their agenda to protect main street investors at a broader roundtable on the proxy process in 2018. Since that time, the rulemaking process has received a wide range of public comments and has been responsive to significant issues posed by the current practices of proxy advisors.

For instance, SEC Commissioner Elad Roisman recently indicated that the final rule would be altered to address concerns from proxy advisors that the proposed process of company pre-review of recommendations would be eliminated in order to ensure investors received recommendations in a timely manner, and that proxy advisors would retain their independence. Roisman also suggested that the Commission impose a speed bump on robo-voting to reduce its prevalence.

Given the lengthy and deliberate rulemaking process and the SEC's responsiveness to public feedback, it is hard to credibly suggest that this effort has been driven by the short-run machinations of a political appointee. Instead, this rule is an outcome of a process that began a decade ago, was done entirely in the public realm, received input from stakeholders on both sides, and will reach a final outcome that will give neither side what they were seeking,

In short, this is precisely how the regulatory process should operate, and the ultimate result comports perfectly with the SEC's explicit mission to facilitate capital formation and protect investors.

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Ike Brannon

Ike Brannon is a former senior economist for the United States Treasury and U.S. Congress.