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Nov. 12, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: Roundtable on the U.S. Proxy Process; File No. 4-725

Dear Mr. Fields,

Nareit appreciates the opportunity to comment on some of the topics to be discussed at the Nov. 15, 2018 Securities and Exchange Commission ("SEC" or "Commission") Roundtable on the Proxy Process[1] (SEC Proxy Roundtable). In our July 25, 2018 comment supporting aspects of the SEC's 2018-2022 Strategic Plan[2], Nareit strongly endorsed the SEC's Draft initiative 2.2 to identify and take steps to address existing SEC rules and approaches that are outdated or are not 'functioning as intended." Nareit and its members believe that the current rules and regulations underpinning the U.S. proxy system are not functioning as intended and should be updated and revised by the Commission.

Nareit is the worldwide representative voice for real estate investment trusts (REITs)[3] and listed real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community.

U.S. REITs were established by Congress in 1960 to give all investors, especially small investors, access to income-producing real estate. Since then, the U.S. REIT approach has flourished and served as the model for more than 35 countries around the world. Investments by retail investors in REITs support properties including offices, apartment buildings, warehouses, retail centers, medical facilities, data centers, cell towers, infrastructure, and hotels.

[1] Securities and Exchange Commission, SEC Staff to Host Nov. 15 Roundtable on the Proxy Process (Sept. 18, 2018) available at: https://www.sec.gov/news/press-release/2018-206.
[2] Nareit Comment on the SEC Draft Strategic Plan, 2018-2011 Release No. 34-83463 (July 25, 2018) available at https://www.sec.gov/comments/34-83463/cll7-4127822-171766.pdf .
[3] REITs are real estate working for you. Through the properties they own, finance and operate, REITs help provide the essential real estate we need to live, work and play. All U.S. REITs own approximately $3 trillion in gross assets, public U.S. REITs account for $2 trillion in gross assets, and stock-exchange listed REITs have an equity market capitalization of over $1 trillion. In addition, more than 80 million Americans invest in REIT stocks through their 401(k) retirement and other investment funds. Additional information available at www.reit.com.

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Nareit commends the SEC for convening the SEC Proxy Roundtable, which we hope will foster a constructive conversation among proxy process participants to address needed reforms. Nareit and its REIT members stand ready to engage with the SEC and other stakeholders as the Commission moves forward to improve the U.S. proxy system. We respectfully offer the following suggestions, which are discussed in greater detail below:

- **Revise the Regulatory Framework Applicable to Proxy Advisory Firms;**
- **Raise the Proxy Proposal Resubmission Thresholds;**
- **Review and Revise Rule 14a-8 Shareholder Proposal Process; and,**
- **Streamline Proxy Disclosures through the SEC's Disclosure Effectiveness Project.**

Our suggestions are discussed in greater detail below.

Revise the Regulatory Framework Applicable to Proxy Advisory Firms

In our recent comments regarding the SEC's Strategic Plan[4], Nareit urged the SEC to review the existing regulatory framework applicable to proxy advisory firms, including a reassessment of the 2004 Egan-Jones and ISS staff no-action letters ("2004 no-action letters")[5] issued by staff of the SEC Division of Investment Management. Nareit believes that the SEC's recent withdrawal of the 2004 no-action letters is an important first step in improving the rules applicable to the dissemination of proxy voting recommendations by proxy advisors. We now urge the SEC to take additional steps to ensure proxy advisors operate fairly, transparently and free of conflict, including issuing necessary regulatory guidance and/or engaging in appropriate rulemaking to achieve this goal.

[4] Supra, note 2.
[5] Egan-Jones Proxy Services, SEC No-Action Letter (May 27, 2004), and Institutional Shareholder Services, Inc., SEC No-Action Letter (Sept. 15, 2004) withdrawn on Sept. 18, 2018 available at https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letter.

Although proxy advisory firms can and do play an important role for some investors, recent studies and surveys,[6] congressional hearings[7] and comments by former SEC Commissioners[8] have documented a variety of concerns expressed by investors, corporate governance experts and other market participants regarding the accuracy of proxy advisory recommendations and the outsized influence of the two dominant U.S. proxy advisors in the annual proxy voting process.

Nareit's member REITs share many of these concerns that have surfaced in this testimony and elsewhere about the "one-size-fits all approach" frequently reflected in voting recommendations, the tendency of proxy advisors to ignore relevant industry, or sector, distinctions, the inconsistent approaches to industry peers, the factual accuracy of some reports and the inability or refusal to correct inaccuracies and the adequacy of their resources to undertake meaningful analysis of thousands of issuers each year. We also note, with some concern, that under current rules, these proxy advisory firms, notwithstanding their outsize influence, operate largely without regulatory oversight, much like the dark pools that the SEC recently appropriately brought into the light.

Additionally, Nareit's members face certain industry-specific issues arising from a voting policy change targeting the REIT industry, adopted in late 2016 by one proxy advisor, Institutional Shareholder Services, Inc. (ISS), at the urging of a labor union (not a pension adviser). Under this so-called "shareholder bylaw amendment policy," ISS now recommends that investors vote against, or withhold votes, for governance and nominating committee board members of firms that do not provide their stockholders with the power to directly (without board approval) amend corporate bylaws and charters. The ISS shareholder bylaw amendment voting policy is set forth in language nearly identical to shareholder proposals made in 2016 to several lodging REITs by a union[9] representing hotel workers, which then held de minimis, e.g., $2000/1 year shares, and is, by ISS' own admission, intended to target

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[6] *See, e.g.,* U.S. Chamber of Commerce and NASDAQ, 2018 Proxy Season Survey (Oct. 2018) available at https://www.centerforcapitalmarkets.com/resource/2018-proxy-season-survey/; Rock Center for Corporate Governance at Stanford University, The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry (June 2018) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3188174; Blackrock, The Investment Stewardship Ecosystem (July 2018), available at: https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf

[7] *See* United States Senate Committee on Banking, Housing, and Urban Affairs, Hearings, Full Committee Hearing, Legislative Proposals to Examine Corporate Governance (June 28, 2018), https://www.banking.senate.gov/hearings/legislative-proposals-to-examine-corporate-governance; United States House Financial Services Committee, Hearing before the Subcommittee on Capital Markets, Securities, and Investment, Legislative Proposals to Help Fuel Capital and Growth on Main Street (May 23, 2018) available at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403426.

[8] *See, e.g.*, Daniel M. Gallagher, Commissioner, U.S. Securities & Exchange Commission, Remarks at the Society of Corporate Secretaries & Governance Professionals (July 11, 2013) (available on SEC website); Michael S. Piwowar, Commissioner, U.S. Securities & Exchange Commission, Speech before U.S. Chamber of Commerce: Advancing and Defending the SEC's Core Mission (Jan. 27, 2014) (available on SEC website).

[9] The ISS 2017 surveys and policy releases used language nearly identical to wording in 2016 proxy proposals submitted by the union group, UNITE HERE, which publishes its proxy activity on a website that it maintains (www.hotelcorpgov.org) that features model proxy proposals (https://www.hotelcorpgov.org/wp-content/uploads/UniteHereBylaw-amendment-proposal-sample.pdf) and advocates corporate governance advocacy against hotel REITs.

Maryland REITs.[10] However, this ISS voting policy has swept in all issuers chartered in states like Maryland and Indiana[11] whose statutory chartering frameworks do not require that shareholders have the ability to propose binding shareholder proposals based on the minimum ownership stakes set forth in Rule 14-a-8, *e.g.*, holdings of at least $2,000 of stock for one year.

In adopting the shareholder bylaw amendment policy ISS asserted, with no supporting authority, that shareholders have a "fundamental right" to amend a corporation's bylaws and charters by a simple majority of votes and to propose such binding amendments predicated on the Rule 14-a-8 minimum, i.e., $2,000 worth of securities held for one year. We have not found support for this assertion at common law, or in judicial precedent. To the contrary, legal scholars concur that in the United States, the right of shareholders to propose binding amendments on corporate bylaws and/or other organizing documents has always been a creature of state law, i.e., there is nothing "fundamental" about it. Nor has ISS ever provided research to suggest that its shareholder bylaw amendment policy is correlated with better performance or outcomes for investors. Rather, the ISS shareholder bylaw amendment policy targeting REITs appears to be an example of a proxy advisory firm making voting recommendations based on a request of an institutional investor client, a practice that has been noted and criticized by experts.[12]

The ISS stance is problematic because the laws in several states such as Maryland and Indiana clearly provide a company's Board of Directors with the exclusive authority to amend its bylaws, unless a company opts out of this statutory default. [13] Therefore, changes made by many REITs to allow shareholders to offer proposals to amend the bylaws under certain conditions creates **additive** rights to shareholders that ISS and shareholders should endorse as an improvement to corporate governance. ISS' stance is also perplexing since it does not recommend any action against governance or nominating

[10] ISS published a report titled Material Restrictions on Shareholders Ability to Amend the Bylaws: A Review of Impacted Maryland Real Estate Companies (July 26, 2017) that left little doubt that REITs were its target. Available at https://www.reit.com/sites/default/files/ISSMaterial-Restrictions-on-Shareholders-Ability-to-Amend-the-Bylaws-Review-of-Maryland-Real-Estate-Companies-July262017.pdf

[11] *See, e.g.*, Eli Lilly and Company's 2018 proxy included a letter from its CEO urging shareholders to disregard ISS' recommendation against a governance committee member, explaining that Eli Lily's charter reserves the ability to amend bylaws to the board of directors, reflecting the "statutory default under Indiana law," and that Eli Lily believes that "ISS's policy on this issue does not fairly apply to Lilly: we have not diminished shareholders' rights under state law in any way, because shareholders do not have the right under Indiana law to amend the bylaws as a statutory default." Available at https://www.sec.gov/Archives/edgar/data/59478/000005947818000131/definitivea14a_2018proxysh.htm.

[12] *See* Statement of Darla C. Stuckey, President & CEO Society for Corporate Governance Before the Committee on Banking, Housing, and Urban Affairs, "Legislative Proposals to Examine Corporate Governance" (June 28, 2018) available at https://www.banking.senate.gov/imo/media/doc/Stuckey%20Testimony%206-28-18.pdf .

[13] See Eli Lilly 2018 proxy supra note 11 ("We believe that ISS's policy on this issue does not fairly apply to Lilly: we have not diminished shareholders' rights under state law in any way, because shareholders do not have the right under Indiana law to amend the bylaws as a statutory default. Lilly's charter has reflected the statutory default under Indiana law of allowing only the board of directors to amend the bylaws for over 80 years.").

committee members of companies based in Delaware that have imposed supermajority requirements in a number of areas, including amending bylaws.[14]

It appears that many of the largest investors in U.S. REITs have decided, after considerable study, to disregard ISS' voting policy targeting REITs. No REIT governance or nominating committee member failed re-election during the 2017 or 2018 proxy seasons solely because the REIT did not conform to the ISS shareholder bylaw amendment policy, although their vote percentages generally ran 15% to 25% below the vote percentages for the non-committee members in both years.

Since ISS first proposed this shareholder bylaw amendment voting policy, at least 17 U.S. REIT chartered in Maryland have attempted to accommodate ISS by adopting a compromise approach modeled on commonly accepted proxy access rules by permitting shareholder-initiated binding bylaw amendments with ownership requirements ranging from 1% for one year by up to five holders (1/1/5) to 3% for three years by up to 20 holders (3/3/20). Remarkably, ISS has rejected most of these measures as inadequate and has continued to recommend voting against or withholding votes from governance committee directors of these firms. As such, ISS has effectively established a *de facto* shareholder "fundamental right" to propose binding proposals to amend the REIT's bylaws or other fundamental organizational documents with ownership stakes that in many cases are lower than the proxy access ownership threshold required to nominate a director, or the threshold required to call for a special meeting.

Although it primarily targets and affects the U.S. REIT sector, we believe that the ISS shareholder bylaw amendment voting policy usefully illustrates why investors would benefit if influential proxy advisors were, like other proxy system participants, required to disclose conflicts and held to customary standards of transparency. Accordingly, Nareit urges the SEC to move forward with regulatory guidance, rulemaking, or a combination of the two, to bring about rule changes applicable to the interactions of investment advisers with proxy advisors to ensure that proxy advisors are held to higher standards commensurate with the principles set forth in Staff Legal Bulletin 20[15] ("SLB 20"), which appropriately emphasize that, investment advisers, as fiduciaries, must exercise proper oversight over a proxy advisory firms.

We additionally urge the SEC to reassess the conditions that a proxy advisory firm must satisfy to be exempt under the Securities Exchange Act from the disclosure and filing requirements that apply to solicitations. We agree with other market participants[16] and sponsors of recent congressional legislation,

[14] A 2017 survey found that roughly 41.9% (1,087 companies out of a sample of 2,594) of U.S. issuers have supermajority provisions for amending one or more provisions of their bylaws See, Scott Hirst, Frozen Charters, 34 Yale J. on Reg. (2017). Available at: http://digitalcommons.law.yale.edu/yjreg/vol34/iss1/3.
[15] Staff Legal Bulletin No. 20, Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms available at https://www.sec.gov/interps/legal/cfslb20.htm.
[16] See U.S. Chamber of Commerce, Report, Best Practices and Core Principles for the Development, Dispensation and Receipt of Proxy Advice (March 2013) available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf.

including H.R. 4015, the Corporate Governance Reform and Transparency Act,[17] which passed the U.S. House of Representatives in 2017, that proxy advisory firms enjoying exemption under the Exchange Act should satisfy the same basic standards applicable to other market participants. Specifically, we recommend that:

- Proxy Advisor reports and recommendations be based on demonstrably accurate information and that sources of voting policy recommendations and methodologies underlying recommendations, including peer group selections and compensation analysis formulas, be fully disclosed.
- All relevant conflicts of interest—including a client's business relationship with an issuer—be fully disclosed and managed.
- Issuers be provided with a meaningful opportunity to engage with proxy advisors and the opportunity to review recommendations and correct inaccuracies.

Raise the Proxy Proposal Resubmission Thresholds

Nareit has long urged the SEC to reassess the resubmission rule for shareholder proxy proposals, set forth in SEC Rule 14a8(i)(12), most recently in our comments on the SEC Strategic Plan 2018-2022[18], when we highlighted this as an important example of an existing SEC rule that is not "functioning as intended".

Under current SEC rules, an issuer may only exclude a shareholder proposal when it has failed to receive the support of 3% of shareholders if voted on once in the last five years; 6% if voted on twice in the last five years; and 10% if voted on three or more times in the last five years. In other words, under current law, a proposal that has been rejected by 90% of shareholders on multiple occasions may be resubmitted again for a shareholder vote. We believe that this situation does not benefit the overwhelming majority of shareholders who have voted against the proposal; to the contrary, it is costly to them and is distracting for both management and shareholders. Moreover, these unnecessary and unproductive distractions caused by an insignificant number of shareholders increase the costs of being a public company, an issue that has been a priority of Chairman Clayton.[19]

[17] H.R. 4015, The Corporate Governance Reform and Transparency Act (115th Congress, 2017-2018) available at https://www.congress.gov/bill/115th-congress/house-bill/4015.
[18] Supra, note 2. In that comment, Nareit also noted that there is a petition pending before the SEC seeking amendment of the Resubmission Rule that was signed by the U.S. Chamber of Commerce, the National Association of Corporate Directors, the National Black Chamber of Commerce, the American Petroleum Institute, the American Insurance Association, the Latino Coalition, the Financial Services Roundtable, the Center on Executive Compensation and the Financial Services Forum (Apr. 9, 2014) available at https://www.sec.gov/rules/petitions/2014/petn4-675.pdf.
[19] *See e.g.,* https://www.sec.gov/news/public-statement/clayton-6-22-17 ("The substantial decline in the number of U.S. IPOs and publicly listed companies in recent years is of great concern to me. Some companies have shifted capital raising activities to the private markets, where many Main Street Americans have limited access. High-quality companies may choose to go public at a later stage, after much of their early growth has already been achieved. Other companies may choose to stay private. This

In 1997, the SEC proposed a rule that would have changed the current 3%/6%/10% regime to a more workable 6%/15%/30% threshold level, thus limiting the number of times that the vast majority of shareholders who oppose a measure would be compelled to pay the costs of an additional vote on an unpopular measure.[20] Nareit strongly recommends that the SEC raise the resubmission thresholds to these levels proposed by the Commission in 1997.[21] Increasing the thresholds in this manner would be a relatively modest step that would preserve the ability of shareholders to introduce proposals for consideration by management and other shareholders, while ensuring that proposals resubmitted for shareholder consideration at shareholder expense have a modicum of support.

Review and Revise Rule 14a-8 Shareholder Proposal Process

The current rules governing shareholder proposals are administered by the SEC under Rule 14a-8 of the Securities Exchange Act, with the broad goal of permitting investors to present constructive proposals for improving a firm's performance and governance to management and fellow shareholders for consideration. Today there is broad agreement that the process is too often hijacked by special interests seeking to advance specialized agendas, some distant from the corporation's purpose and/or operations. For this reason, Nareit urges the SEC to reassess the process by which it administers shareholder proposals under Rule 14a-8. In doing so, Nareit encourages the SEC to consider: 1) withdrawing SEC Staff Legal Bulletin 14H; (2) implementing measures to provide investors with greater transparency regarding the source of shareholder proposals; and, (3) clarifying that an investment adviser's fiduciary duty of care does not require that the adviser vote on every item on a proxy.

Staff Legal Bulletin 14H[22], issued in early 2015 to address a specific shareholder proposal submitted to Whole Foods, has—intentionally or otherwise—greatly limited the ability of issuers to rely on an exemption under Rule 14a-8(i)(9) permitting the exclusion of a proposal that conflicts with one of the company's own proposals. Nareit members believe that Rule 14a-8(i)(9), appropriately applied, benefits shareholders and firms alike by permitting the exclusion of similar proposals that could confuse voting shareholders and produce ambiguous voting data. Nareit members also note that although Staff Legal Bulletin 14H was ultimately far-reaching in its effect, it was never considered or approved by the full Commission. We urge the SEC to reassess the basis for and continued usefulness of Staff Legal Bulletin 14H.

Nareit's members also urge the SEC to issue guidance or take other regulatory measures to ensure that investors have sufficient information regarding the proponents of shareholder proposals to evaluate them

ultimately results in fewer opportunities for Main Street Americans to share in our economy's growth, at a time when we are asking them to do more on their own to save and invest for their future and their children's futures.")

[20] Proposed Rule: Amendments to Rules on Shareholder Proposals Release No. 34-39093. Sept. 19, 1997 ("SEC 1997 Proposal") available at https://www.sec.gov/rules/proposed/34-39093.htm

[21] Proposed Rule: Amendments to Rules on Shareholder Proposals Release No. 34-39093 Sept. 19, 1997

[22] SEC, Staff Legal Bulletin 14H (Oct. 22, 2015) available at https://www.sec.gov/interps/legal/cfslb14h.htm

properly. Today, shareholders often do not know key facts that are essential to evaluate the merits of a shareholder proposal including, whether the proponent is acting on his/her own, or as a representative of another interest; the number of shares held by the proponent; whether the proponent holds short positions; whether the proponent has relevant conflicts of interest; whether the proponent has submitted similar proposals to other firms, and whether the proponent has a history of proxy activism. The SEC has long required that firms provide this kind of information about corporate management and board members to investors and has regarded such information as essential to informed investing. Nareit urges the SEC to extend this transparency principle to proponents of proxy proposals included in a firm's proxy.

Finally, Nareit urges the SEC to clarify in guidance that an investment adviser's fiduciary duties do not include a legal obligation to vote on every item on a proxy card, which appears to be a widespread misunderstanding of the current regulatory landscape. Clearly, it is in the best interest of investors if advisers weigh the benefits of voting on certain matters against the cost of research—including expenditures on third party proxy advisors.

Streamline Proxy Disclosures through the SEC's Disclosure Effectiveness Project

Nareit has strongly endorsed the SEC's ongoing Disclosure Effectiveness Project to address outdated, duplicative and confusing disclosure obligations and has submitted comments to the SEC supporting its 2015 Request for Comment on the Effectiveness of Financial Disclosures about Entities other than the Registrant[23], 2016 Concept Release on Business and Financial Disclosure Required by Regulation S-K;[24] its related 2016 Disclosure Update and Simplification Proposal[25], and its recent Strategic Plan 2018-22 initiative.[26] In our various comments to the SEC, Nareit has focused on specific areas when our members believe that existing SEC disclosure rules and regulations applicable to REITs might be streamlined and/or improved for the benefit of REIT investors. Additionally, we believe that the Disclosure Effectiveness Project provides a useful opportunity to consider ways to update and modernize proxy disclosures to help investors make better informed proxy voting decisions.

[23] Nareit comment on SEC *Request for Comment on the Effectiveness of Financial Disclosures about Entities other than the Registrant*; Release No. 33-9929; 34-75985; File No. S7-20-15 (Nov. 30, 2015) available at https://www.sec.gov/comments/s7-20-15/s72015-17.pdf
[24] Nareit comment on SEC *Concept Release on Business and Financial Disclosure Required by Regulation S-K*; 17 CFR Parts 210, 229, 230, 232, 239, 240 and 249; Release Nos. 33-10064, 34-77599; File No. S7-06-16; RIN 3235-AL78 (July 21, 2016) available at https://www.sec.gov/comments/s7-06-16/s70616-268.pdf.
[25] Nareit comment on *SEC Proposed Rule on Disclosure Update and Simplification* (17 CFR Parts 210, 229, 230, 239, 240, 249, and 274; Release No. 33-10110, 34-78310; IC32175; File No. S7-15-16; RIN 3235-AL82) (Oct. 28, 2016) available at https://www.sec.gov/comments/s7-15-16/s71516-39.pdf.
[26] Supra, note 2.

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Conclusion

Nareit commends the Commission for convening the SEC Proxy Roundtable to initiate a public conversation surrounding these important issues related to the proxy system. Bringing greater transparency and accountability to the rules underpinning proxy advisory activity and addressing troubling conflicts of interest is essential to maintaining investor trust and confidence in U.S. public companies. Nareit and its members are eager to work with the SEC and fellow market participants to modernize our proxy rules and stand ready to assist in any way that we can.

Please contact me at tedwards@nareit.com or Victoria Rostow, Nareit's Senior Vice President, Policy & Regulatory Affairs at vrostow@nareit.com if you would like to discuss these issues in greater detail.

Respectfully submitted,

Tony M. Edwards
Executive Vice President & General Counsel