



September 10, 2024

**Committee:** House Financial Services Subcommittee on Oversight and Investigations  
**Title:** “The Fall of ESG: Scrutinizing the Failed Use of ESG Standards *and* the Influence of Proxy Advisors.”  
**Date / Time:** Tuesday, September 10, at 2:00 p.m.  
**Location:** Rayburn HOB, Room 2129  
**Statement:** Timothy M. Doyle, Founder & Principal of Doyle Strategies, LLC

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Good afternoon, Chairman Huizinga, Ranking Member Green, and members of the subcommittee. Thank you for inviting me to testify today.

My name is Tim Doyle, and I am the Founder and Principal at Doyle Strategies, LLC, which provides consulting services on ESG, corporate governance, and the federal regulatory process. For over four years I spearheaded the ESG and Corporate Governance Program at the Bipartisan Policy Center, and I am currently a senior advisor for Centerline Liberties and author of newly released white paper on the anti-ESG efforts at the state level, which has been included in my submitted materials for the record. All opinions I express today are my own and do not necessarily reflect the views of any clients or associated organizations.

### **ESG: Dynamic and Subjective<sup>1</sup>**

Environmental, Social, and Governance (“ESG”) in general should be understood as a subjective concept describing dynamic nontraditional economic factors that may affect financial returns. From early religious investors who excluded “sin stocks” (e.g., alcohol, gambling, oil and gas, and tobacco) from their portfolios to modern quantitative investors searching for ESG outperformance or corporate boards and management integrating ESG into business decisions to maximize shareholder value and create long-term value, stakeholders have considered nontraditional factors in a myriad of ways. As a result, there is no one standardized definition of ESG and no one way that investors or businesses incorporate ESG into their decision making. This has created confusion about what it is and how it should be used. Both Congress and the U.S. Securities and Exchange Commission (“SEC”) have had multiple opportunities to define ESG but have not come to a consensus.<sup>2</sup> This has meant that investors and corporate boards have to determine what specific ESG-related factors are material to their portfolios or business decisions. It is therefore not up to the SEC to define the risk factors, but only to ensure any material risks identified are disclosed. For simplified purposes, I divide ESG into its two basic uses from both an investment and corporate perspective: 1) Integration and 2) Impact.

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<sup>1</sup> Doyle, Timothy M., *Centerline Liberties*, “ESG: Politics Over Policy and the Consequences” (White Paper), (Sept. 10, 2024); available at <https://centerlineamerica.com/esg-report/>

<sup>2</sup> See Statement of SEC Commissioner Hester Peirce, “Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies,” (May 25, 2022); available at <https://www.sec.gov/newsroom/speeches-statements/peirce-statement-esg-052522>; see also H.R. 1187, “Corporate Governance Improvement and Investor Protection Act,” 117<sup>th</sup> Congress (2021-2022); (Passed the House, but died in the Senate), (While the bill includes a provision that the sense of Congress is that ESG metrics are *de facto* material with regard to SEC disclosure, the bill does *not* define ESG.); available at <https://www.congress.gov/bill/117th-congress/house-bill/1187/text>

Integration, sometimes referred to as “outside/in” is when ESG factors that are economically relevant are integrated in either an investment or business decision. Most of the fortune 500 companies use certain ESG factors in this way; however, it is the least acknowledged in the current political rhetoric surrounding ESG. From the investment side, all economically relevant factors, including ESG, are integrated in investment decisions. From the corporate side, all economically relevant factors are integrated in making decisions about value creation. ESG factors can be difficult to evaluate because “economic relevance” can be inherently subjective. However subjective it may be, determining economic relevance is guided by a fiduciary duty.

Impact, sometimes referred to as “inside/out,” arguably the most controversial, is when ESG factors are used to mitigate a negative externality or create a positive one, in addition to acquiring a reasonable rate of return or creating long-term value. This type of use sometimes conflates the “benefits” in an investment context or “reasonable business decisions” in a corporate context typically associated with a fiduciary duty, with those associated with pursuing an impact in the context of a political, social, or ideological goal. From the investment side, “impact investing” has been around much longer than the term ESG and is historically connected to religious-based goals or environmental impacts. More recently, this type has focused on climate-related goals, though this is becoming more economically integrated requiring a competitive rate of return. In some cases, so called “concessionary investing,” the ESG impact is based on the idea that one would concede a certain level of return on investment if it meant the identified goal would be achieved. From a corporate perspective, this type of use is most closely associated with a “corporate social responsibility” goal, though this has more recently shifted toward a broader focus involving sustainability.

The politicization of ESG is in part due to a lack of understanding of how ESG is being used. On the one hand, claiming ESG is *always bad*, as is commonly done by those that don’t agree with using ESG to achieve political, social, or ideological goals, implies a lack of understanding that ESG factors can be no different than other risks and opportunities that a prudent person would consider before making an investment or business decision. Here investment advisors or business executives must be given the flexibility, within their fiduciary duties, to make decisions using all relevant factors.

On the other hand, a relevant ESG factor to one company or to an investment strategy may not be considered as such to another. Thus, claiming that ESG is *always good*, as is commonly done by those that think societal problems should be addressed through the capital markets because of a lack of Congressional action, implies a lack of understanding that ESG factors are not always relevant to an investment or business decision. Here the proper venue for society’s greatest challenges is the legislature through vigorous debate and hopefully compromise. The hyper-politicization of ESG has led both academics and more recently Fortune 100 CEOs to call for either the breakup of the term “ESG” or to simply stop using the acronym altogether.

One of the consequences of misconstruing ESG led to the rise and fall of ESG-related funds. In 2021, ESG funds had record influxes of investment dollars as the idea of ESG “always being good” was embraced by Wallstreet.<sup>3</sup> However, the theory was tested on February 24, 2022, when Russia invaded Ukraine

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<sup>3</sup> Clements, Ross R., *Mayer|Brown*, “The Rise and Fall of ESG: A Brief History and A (Hopeful) Look Ahead,” (Apr. 25, 2023); available at <https://www.mayerbrown.com/en/insights/publications/2023/04/the-rise-and-stall-of-esg-a-brief-history-and-a-hopeful-look-ahead>

resulting in an underperforming energy sector swinging back to life with oil prices rising to 2014 levels.<sup>4</sup> Then in early 2022, it became apparent that the Federal Reserve was going to raise interest rates, which analysts correctly predicted would hit growth stocks more than others and technology stocks correspondingly took a significant hit throughout 2022.<sup>5</sup> What some investors didn't realize was that ESG-related funds were historically overweighted in the technology sector and underweighted in the energy sector. Interestingly though, while technology stocks have recovered since 2022, ESG-related funds have not. Whether this is because of inconsistencies in how ESG was defined, used, rated, or merely its political toxicity, more research is needed on the underlying factors that comprise ESG.<sup>6</sup>

### Proxy Process in Corporate Governance

In the context of corporate governance, the proxy process is a mechanism to allow beneficial owners (shareholders) the ability to vote either by mail or to designate a fiduciary to act as their agent to vote on their behalf at annual general meetings. This is a practical solution to avoid having shareholders attend multiple meetings scheduled at various companies across the country.

Since the growth of public markets from the 1900s, and in particular since the end of World War II, there has been constant tension between shareholder rights and corporate boards and executive management. This tension has been at the center of the proxy process and has correspondingly resulted in a long history of litigation. The tension has been amplified by the fact that, since the 1990s, the ownership of publicly traded companies has become much more concentrated through investments managed by asset managers and institutional investors.

As mutual funds, exchange traded funds (ETFs), and pension funds continued to grow over the years, encompassing ever larger and more diverse sectors of publicly traded companies, there was a perceived need to vote on proposals in an increasing number of annual meetings. This need was bolstered by SEC regulatory action and the Department of Labor's issuance of the "Avon Letter" in the 1980s, which emphasized fiduciary duty and the importance of proxy voting. Ultimately, this need created the market for proxy advisors and their ability to review proxy materials at thousands of companies and provide analysis and recommendations. How they develop their recommendations and how those recommendations impact voting results is an issue of increasing concern.

Furthermore, in conjunction with the proxy process, Rule 14a-8 of the Securities and Exchange Act of 1934 provides the framework for shareholders to request that their individual proposals be voted on at corresponding shareholder annual meetings. These proposals, if not otherwise excludable under 14a-8's provisions, would be included in the proxy materials provided to all shareholders before the next annual meeting.

<sup>4</sup> See Sommer, Jeff & Granville, Kevin, *New York Times*, "Stocks and Energy Markets Whipsaw After Russian Attack on Ukraine," (Feb 24, 2022); available at <https://www.nytimes.com/2022/02/24/business/economy/stock-market-today.html>

<sup>5</sup> See Krauskopf, Lewis, *Reuters*, "Why the U.S. stock market is tumbling in 2022," (May 11, 2022); available at <https://www.reuters.com/business/finance/why-us-stock-market-is-tumbling-2022-2022-05-11/> see also, Q.ai, *Forbes*, "Why Were Tech Stocks Down In 2022-And How Long Will the Slump Last," (Jan. 19, 2023)(This is the first time I have cited "Q.ai"); available at <https://www.forbes.com/sites/qai/2023/01/19/why-were-tech-stocks-down-in-2022-and-how-long-will-the-slump-last/>

<sup>6</sup> See Anderson, Julie, *American University, Kogod School of Business*, "Is ESG Investing Dead?" (Jun. 4, 2024); available at <https://kogod.american.edu/news/is-esg-investing-dead#:~:text=Evidence%20of%20Decline,%249.3%20billion%20in%20a%20year.>

As a result, the subject matter of suggested shareholder proposals and determining who ultimately decides how to vote on those proposals is increasingly debated. This issue is compounded by the fact that the beneficial owners of the shares have increasingly designated, by proxy, their voting rights to third parties, who in turn rely on proxy advisor recommendations for a variety of reasons. Further, under the current policy of the SEC, shareholder proposals dealing with broader societal issues, that might have otherwise been excluded under Rule 14a-8, are now being more readily included in proxy materials.

***The changing process by which corporate policy is voted and acted upon makes the proxy process a vitally important part of corporate governance. The importance of the process has led to bipartisan calls for improving and reforming it for decades. Congress should continue to carefully analyze sustainable reforms to improve the proxy process.***

## Disclosure & Materiality

Disclosure is at the center of the ESG debate. Determining what is disclosed involves numerous factors depending on if it is legislatively mandated, regulatorily required, or individually requested at annual shareholder meetings. Most of the debate around disclosure focuses on the shareholder proposal process and the SEC's disclosure framework. While disclosure is at the center of the ESG debate, materiality is arguably at the center of the disclosure debate.

### *Background on Disclosure: Regulation S-K and ESG*

As this committee is well aware, the SEC is the lead regulatory agency for corporate disclosure. This falls under their tripartite mission to “protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.”<sup>7</sup> Over the years the SEC has created a framework of disclosure in furtherance of their mission. While most people understand the need for the disclosure of financial data for investors to make informed investment decisions, there has been growing interest in what has been referred to as non-financial data. ESG and other climate-related data have, until relatively recently, fallen under this category of non-financial data.

The SEC has traditionally regulated non-financial data through Regulation S-K (“Reg. S-K”). Reg. S-K is the foundation of the existing framework for determining what non-financial information should be disclosed by issuers to the SEC.<sup>8</sup> Since its drafting in 1977, Reg. S-K has been updated numerous times as interest in various disclosure issues have developed.<sup>9</sup> Before the SEC's stayed their most recent Climate Disclosure Rule, the SEC addressed what would be considered ESG-related disclosure issues, including climate-related risk, through its 2010 interpretive guidance (“2010 guidance”) to Reg. S-K.<sup>10</sup> As a result, using a materiality analysis to determine what to disclose under the 2010 guidance has been at the center of the disclosure debate for non-financial data.

<sup>7</sup> SEC, “About the SEC”; available at <https://www.sec.gov/about>

<sup>8</sup> See “Commission Guidance Regarding Disclosure Related to Climate Change,” (“2010 Guidance”) (Feb. 8, 2010), (Analysis of climate-related disclosure under Items 101 Description of Business; 103 Legal Proceedings; 105 Risk Factors; and revised 303 Management’s Discussion & Analysis); available at <https://www.sec.gov/rules/interp/2010/33-9106.pdf>

<sup>9</sup> See “Adoption of Disclosure Regulation and Amendments of Disclosure Forms and Rules,” Release No. 33-5893 (Dec. 23, 1977); 42 FR 65554 (Dec. 30, 1977).

<sup>10</sup> See 2010 Guidance at *supra* note 8 (Feb. 8, 2010); available at <https://www.sec.gov/rules/interp/2010/33-9106.pdf>

By the time Reg. S-K was finalized in the late 1970s, the issue of what type of information had to be disclosed had already been litigated numerous times and the SEC had already been using their own definition of materiality.<sup>11</sup> The seminal case involving the materiality standard was the 1976 Supreme Court case *TSC Industries vs. Northway*.<sup>12</sup> Justice Marshall’s unanimous<sup>13</sup> opinion has probably been cited more often than any other case when discussing disclosure. The court held that a fact is “material,” and thus should be disclosed, “if there is a substantial likelihood that a reasonable shareholder would consider it important ....”<sup>14</sup> The court also held that when determining what to disclose “there must be a substantial likelihood that the disclosure ... would have been viewed by [a] reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>15</sup> The SEC has recognized, cited, and used both the “substantial likelihood” and “total mix” language from TSC Industry and its progeny of cases multiple times.<sup>16</sup> It is worth noting that the court acknowledged that applying a materiality standard could be difficult and stressed that materiality was “a mixed question of law and fact” and that it should only be found as a matter of law if “reasonable minds ... [could not] differ on the question of materiality.”<sup>17</sup> This last point is of particular importance given the attempt, in 2021, to pass a sense of Congress that ESG metrics are *de facto* material.<sup>18</sup> Given that the bill passed by one vote, it exemplifies that reasonable minds can and do differ on the parameters of material disclosure.<sup>19</sup>

Another area of concern, in fact one that the SEC expressed to the court, was the need to strike a balance between adequate disclosure on the one hand and having too low a standard for disclosure on the other.<sup>20</sup> In agreeing with the SEC at the time, the court found that “some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good”<sup>21</sup>

<sup>11</sup> See *TSC Industry, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) (“TSC Industry”).

<sup>12</sup> *Id.*

<sup>13</sup> Justice Stevens took no part in the case or decision.

<sup>14</sup> *TSC Industry*, *supra* note 11, at 449 (The holding applied to a decision on voting. The same rationale was used to extend its application to a decision to buy, sell, or hold a security in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

<sup>15</sup> *Id.*

<sup>16</sup> Proposal, *infra* note 31, at 64 (Fn. 209 Citing 17 CFR 240.12b-2, under the *Exchange Act*, definitions “The term ‘material,’ when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.”); see also 17 CFR 230.405 (Under the *Securities Act*, definitions “The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered”); see also Proposal at 166 (The Commission’s discussion of applying the materiality standard to Scope 3 emissions).

<sup>17</sup> See *TSC Industry*, *supra* note 11, at 448.

<sup>18</sup> Corporate Governance Improvement and Investor Protection Act of 2021 (Jun. 16, 2021) (H.R.1187 was a large omnibus bill that had numerous disclosure provisions in over ten titles.); available at <https://www.congress.gov/bill/117th-congress/house-bill/1187/actions>

<sup>19</sup> Timothy M. Doyle, BPC Blog “‘Disclosure Act’ (H.R.1187): What it Means for the SEC and Other Stakeholders” (Aug. 25, 2021) (“The bill would have required the SEC to mandate disclosing information on political expenditures; pay ratios of certain employees; climate risk; tax havens; workforce demographics; workplace harassment; cyber security; board diversity; and forced labor. Proponents of the legislation argued investors need more ESG (including climate-related risk) information to make sound investment decisions. Opponents argued that under the existing regulations and materiality standard the types of information listed are already required to be disclosed if the information is material to a reasonable investor.”); available at <https://bipartisanpolicy.org/blog/disclosure-act/>

<sup>20</sup> See *TSC Industry*, *supra* note 11, at 449 Fn. 10 (SEC filed an Amicus Brief with the U.S. Supreme Court).

<sup>21</sup> *Id.* at 448-9.

### Materiality Considered

The SEC is currently not obligated to include a materiality requirement to its proposed disclosures, though it is required to give a rational basis for its disclosure rules. Furthermore, while the SEC has no specific authority to require disclosure because it is material, companies are also under no obligation to disclose something unless there is a duty to disclose. As a result, historically, materiality has been used to bridge the gap between broad statutory language and specific disclosure requirements.

Mandating a materiality standard for disclosure would allow the SEC to address new disclosure issues without over burdening companies with disclosing endless amounts of information that any given investor finds relevant, and the potential of overwhelming investors by what the court described as an “avalanche” of data.<sup>22</sup> In addition, adding a materiality standard could help insulate new disclosure requirements from litigation claiming a proposed disclosure requirement does not promote efficiency, competition, and capital formation and therefore may be considered “arbitrary and capricious.”<sup>23</sup>

While mandating a materiality standard for disclosure may be too simplistic of a solution for some, given the complexity of corporate disclosure and how and when materiality is applied, it can’t be ignored that this standard has withstood the test of time for over 40 years. In writing the *TSC Industries vs. Northway* opinion, Justice Marshall seemed to understand the parameters of such a simple rule, but he also understood there would be “close calls.” Important for contemplating legislative action is that the Court acknowledged that “doubts as to the critical nature of information misstated or omitted [would] be commonplace”<sup>24</sup> and the decision should favor disclosure in such cases as the securities laws are meant to “protect investors.”<sup>25</sup> However, the court also explained that the deference to disclosure is based in part on the fact that issuers would presumably have “control” of the information to be disclosed.<sup>26</sup>

### BPC Discussions and Comments

In spearheading the ESG and corporate governance program at the Bipartisan Policy Center (“BPC”), I was active in the ongoing public discussion around disclosure, materiality, and other ESG-related issues, having submitted several comments to the SEC. Those comments were largely based on numerous events held and with input from BPC membership. Specifically, BPC submitted comments<sup>27</sup> on materiality to the SEC in response to then-Acting SEC Chair Allison Herren Lee’s 2021 request.<sup>28</sup> Then on July 20, 2021, BPC hosted an event to discuss ESG disclosure and H.R.1187 with Congressmen Gregory Meeks (D- NY) and Bill Huizinga (R-MI).<sup>29</sup> That was followed by an October 28, 2021 panel event on

<sup>22</sup> TSC Industry, *supra* note 11, at 449-450.

<sup>23</sup> 15 U.S.C. §78c(f) and §§78w(a)(2) and 80a– 2(c); see also *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); see also *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 177 (D.C. Cir. 2010).

<sup>24</sup> *Id.*; see also *TSC Industry, supra* note 11, at 448 (Citing *Mills v. Electric Auto-Lite Co.*, 396 U. S. 375, 381 (1970).

<sup>25</sup> *Id.* *TSC Industry, supra* note 11, at 448.

<sup>26</sup> See *id.* (This issue has become more important to the extent that any of the currently proposed SEC disclosure rules require disclosure of information not within the possession of the issuer.)

<sup>27</sup> BPC comments in response to then-Acting Chair Allison Herren Lee’s, March 15, 2021 Statement “Public Input Welcomed on Climate Disclosure” (Jun. 11, 2021); available at <https://www.sec.gov/comments/climate-disclosure/cl12-8911531-244352.pdf>

<sup>28</sup> Then-Acting Chair Allison Herren Lee, Statement “Public Input Welcomed on Climate Disclosure” (Mar. 15, 2021); available at <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>

<sup>29</sup> BPC event “ESG Disclosure: A Conversation with Reps. Gregory Meeks and Bill Huizinga,” (July 20, 2021) (Panel discussion with Hon. Gregory Meeks (D-NY) and Hon. Bill Huizinga (R-MI) to discuss ESG Disclosure and H.R.1187 the Corporate



materiality with professors Jill Fisch and Amanda Rose, both experts and leading academic voices on the topic.<sup>30</sup> Then, after the release of the SEC’s proposed “Climate Disclosure Rule,” in March of 2022,<sup>31</sup> BPC hosted another event on April 7, 2022, with former SEC Commissioner Troy Paredes discussing various aspects of the proposed rule including materiality.<sup>32</sup> BPC then submitted comments to the SEC on the proposed climate disclosure rule.<sup>33</sup> Then BPC hosted a fireside chat with Representative Bill Huizenga (R-MI) in which materiality was again the topic of discussion.<sup>34</sup> Lastly, BPC hosted an event on April 13, 2023, to discuss the Department of Labor’s rule on retirement savings wherein materiality was an integral part of the discussion.<sup>35</sup>

### *Other Organizations That Support a Materiality Analysis*

It is also worth mentioning that the benefits of using materiality have been recognized by other organizations. For example, the SEC’s Investor Advisory Committee recommended that “the Commission take action to ensure investors have the material, comparable, consistent information about climate and other ESG matters that they need to make investment and voting decisions.”<sup>36</sup> The SEC modeled their proposed Climate Disclosure Rule on the recommendations from the Task Force on Climate-Related Financial Disclosures (TCFD).<sup>37</sup> Specifically noteworthy is that the TCFD’s disclosure framework was based on the evaluation of “material climate-related risks and opportunities.”<sup>38</sup> The International Sustainability Standards Board’s (ISSB) proposed standards require companies to “provide all material information related to significant sustainability matters that are relevant to investors’ decision-making,

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Governance and Improvement Protection Act of 2021), available at <https://bipartisanpolicy.org/event/esg-disclosure-meeks-huizenga/>

<sup>30</sup> BPC event “Do We Need to Rethink Materiality,” (Oct. 28, 2021) (Panel discussion with Professors: Jill Fisch, University of Pennsylvania Carey Law School and Amanda Rose, Vanderbilt University Law School); available at <https://bipartisanpolicy.org/event/do-we-need-to-rethink-materiality/>; see also Timothy Doyle, BPC Blog “What is Materiality” (Oct. 27, 2021); available at <https://bipartisanpolicy.org/explainer/what-is-materiality/>

<sup>31</sup> SEC Release “The Enhancement and Standardization of Climate-Related Disclosures for Investors” (March 21, 2022, later conformed to the Federal Register versions) (“Proposal” or “Rule”); available at <https://www.sec.gov/rules/proposed/2022/33-11042.pdf>; see also the proposed Rule (Apr. 11, 2022), 87 FR 21334; available at <https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors>

<sup>32</sup> BPC event “Corporations and Climate: Potential Impacts of the SEC’s Proposed New Rule,” (Apr. 7, 2022) (Discussion with former SEC Commissioner Troy Paredes); available at <https://bipartisanpolicy.org/event/corporations-and-climate-potential-impacts-of-the-secs-proposed-new-rule/>

<sup>33</sup> BPC submitted comments to the SEC regarding the proposed rule titled “The Enhancement and Standardization of Climate-Related Disclosures for Investors,” (June 13, 2022); available at <https://www.sec.gov/comments/s7-10-22/s71022-20131026-300399.pdf>

<sup>34</sup> BPC event “Where Does the ESG Debate Go from Here?” (December 12, 2022) (Discussion with Hon. Bill Huizenga (R-MI), available at <https://bipartisanpolicy.org/event/esg-debate/>

<sup>35</sup> BPC event “What’s ESG got to do with It? The impact of DOL’s rule on retirement savings,” (April 13, 2023) (Discussion with panelists Robert Eccles, Visiting Professor of Management Practice at the Said Business School, Oxford University; Anson Frericks, Co-Founder and President Strive Asset Management; Clara Miller, Advisor, Social Sector Finance; President Emerita Heron Foundation); available at <https://bipartisanpolicy.org/event/dol-impact-on-retirement-savings/>

<sup>36</sup> Proposal, *supra* note 31, at 28-29.

<sup>37</sup> Proposal, *supra* note 31, at 37-39; see also TCFD’s final report and recommendations, p. 14 (2017) (TCFD framework include eleven recommendations including four top level: Governance; Strategy; Risk Management; and Metrics & Targets); available at <https://www.fsb-tcfid.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf>

<sup>38</sup> Proposal, *supra* note 31, at 39 (While TCFD’s definition of materiality is broader than that which is used in the U.S. for SEC disclosure purposes, it is of note that there is a materiality analysis required in determining disclosure. One presumes that the SEC will be applying the U.S. definition in their disclosure framework.)

including thematic and industry-based requirements.”<sup>39</sup> The importance of materiality was also reinforced by the Value Reporting Foundation’s May 6, 2023, comments to the SEC.<sup>40</sup> While TCFD, VRF, and the ISSB, have a broader definition of materiality than traditionally used by the SEC, they all nonetheless expressed the importance of a materiality qualifier as part of their disclosure frameworks.<sup>41</sup>

***Materiality is at the center of the disclosure debate. While keeping in mind that both the SEC’s tripartite mission and congressional intent have been to create the world’s most robust capital markets, protect investors, and maintain fair, orderly, and efficient markets, Congress should consider codifying the Supreme Court’s, and historically the SEC’s, standard for disclosure. Doing so would improve regulatory certainty for both investors and issuers.***

### Proxy Advisors

The transition in retirement systems from defined benefit to defined contribution may have been the single most influential factor in the exponential growth of institutional investors over the last couple of decades.<sup>42</sup> As their assets under management and corresponding ownership in publicly traded companies increased, 70% by some estimates,<sup>43</sup> their responsibility to address shareholder rights on behalf of beneficial owners has also grown. This growth created a need to analyze and submit proxy votes at thousands of shareholder meetings each year. For example, in 2019, institutional investor Vanguard voted on over 169,000 proposals.<sup>44</sup> The New York City comptroller’s office cast 71,000 ballots at 7,000 shareholder meetings in the first six months of 2018.<sup>45</sup> The sheer number of ballots that are reviewed and voted on has led to the growth of proxy advisory firms whose function is to review shareholder proposals and provide voting recommendations.

There are two firms, Institutional Shareholder Services (ISS) and Glass Lewis, that make up almost 97% of the market. However, concerns have been raised about the influence these firms have over voting results. As a result, questions have been raised about their recommendations and whether there should be more oversight and transparency around the proxy process and their recommendations to investors.<sup>46</sup> Specifically, concerns regarding conflicts of interest including how their recommendations

<sup>39</sup> ISSB FAQ, “How will the ISSB’s standards approach materiality”; available at

<https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/>

<sup>40</sup> See Janine Guillot, CEO Value Reporting Foundation (VRF) Comment on the Enhancement and Standardization of Climate-Related Disclosures for Investors (May 6, 2022) (VRF, formerly SASB, will merge with ISSB in 2022); available at <https://www.sec.gov/comments/s7-10-22/s71022-20127884-289400.pdf>

<sup>41</sup> The VFR, at least when they referred to themselves as SASB, used a materiality standard based on the SEC’s historic definition of materiality. However, the TCFD and presumably the ISSB look at materiality not only from how the human environment affects a company, but also how a company’s action affects the human environment. This is typically referred to as “double” materiality.

<sup>42</sup> Dec. 27. 2021 CRS *In Focus* “A visual depiction of the shift from defined benefit to defined contribution pension plans in the private sector”; available at <https://crsreports.congress.gov/product/pdf/IF/IF12007>

<sup>43</sup> May 27, 2021, Paul Rose, Ohio State University College of Law, “Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting,” Harvard Law School Forum on Corporate Governance; available at <https://corpgov.law.harvard.edu/2021/05/27/proxy-advisors-and-market-power-a-review-of-institutional-investor-robotvoting/>

<sup>44</sup> Vanguard Comments to the SEC’s Roundtable on the Proxy Process” (Sept. 20, 2019); available at <https://www.sec.gov/comments/4-725/4725-6168191-192387.pdf>

<sup>45</sup> *Id.*

<sup>46</sup> BPC has hosted three public events as well as private roundtables on these important issues. We have been closely following the SEC actions on these matters since the November 2018 roundtable. On January 27, 2020, BPC hosted *The Proxy Process Reformed*, a discussion of proposed rule Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice.



are developed, erroneous reports supporting their recommendations, and the practice of what has been termed “robo-voting.”

One of the issues that led to the concern about proxy advisory influence was that ISS and Glass Lewis appeared to offer similar vote recommendations for the same type of non-financial issues. As a result, there was a realization that their recommendations could have a significant effect on voting results. This impact was amplified by the growth of institutional investors.<sup>47</sup> Studies have shown that proxy advisor recommendations can have a significant impact on any given vote.<sup>48</sup> This includes both a direct impact on the vote tally and an indirect influence on corporate managers in how they attempt to avoid a negative recommendation.<sup>49</sup>

To complicate matters, investors and advocacy organizations have become more active in using corporate governance structures, such as proxy voting, in an attempt to affect business decisions on issues ranging from environmental protection to human rights. This begs the broader question of the extent to which the private sector should engage on public policy issues, and more specifically whether the current corporate governance structure was designed to facilitate these activities.

For over a decade there has been a bipartisan effort to implement additional oversight of proxy advisors and the proxy process more generally. I will focus on three concerns regarding proxy advisors including: 1) conflicts of interest; 2) errors in reports; and 3) automatic and robo-voting. Other issues such as, duties of financial advisors, resubmissions thresholds, ordinary business exclusion, rights of beneficial owners, and liability have also been considered as part of reforming the proxy process.

### *Conflicts of Interest*

There are two types of conflicts of interest with proxy advisors, one of which is unique to ISS. Specifically, ISS offers recommendations on proposals that are submitted for a vote by the same issuers to whom they offer consulting services on how to change or obtain favorable recommendations. ISS has explained that they have developed a process for addressing these types of conflicts by creating a “firewall” to insulate the different business lines based on guidelines used to determine the extent of the conflict. While actual conflicts are not publicly revealed, if one exists, clients are notified. ISS claims that any attempt to require them to disclose actual conflicts will weaken or destroy the firewall they are required to maintain.<sup>50</sup> However, proponents of proxy advisor reform have indicated that revealing guidelines to the assessment process used to determine conflicts of interest are insufficient to alleviate the appearance of impropriety.

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We had panelists Pat McGurn, Special Counsel and Head of Strategic Research and Analysis at Institutional Shareholder Services, Inc. (ISS) and Tom Quaadman, Executive Vice President at U.S. Chamber of Commerce Center for Capital Markets Competitiveness (U.S. Chamber).

<sup>47</sup> James R. Copland, David F. Lacker, and Brian Tayan, “Proxy Advisory Firms: Empirical Evidence and the Case for Reform,” (May 2018); available at, <https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf>

<sup>48</sup> See id.

<sup>49</sup> See id.

<sup>50</sup> BPC panel discussion on “The Proxy Process Reformed,” with panelists Pat McGurn, Proxy Advisory ISS and Tom Quaadman, EVP U.S. Chamber (CCMC), moderated by BPC Sr. Advisor Timothy Doyle, *Bipartisan Policy Center* (January 27, 2020); available at <https://bipartisanpolicy.org/event/the-proxy-process-reformed/>

The second potential conflict of interest is that some of the proxy advisors provide analyses to the same entities that regularly *submit* shareholder proposals. ISS claims that it has a set of policies that prevent conflicts from inappropriately affecting their decisions and that they notify clients of conflicts when they arise.<sup>51</sup> Others have argued that there is little to no oversight to ensure that the policies and procedures referenced are in fact followed.<sup>52</sup> The issue appears not to be about whether there are conflicts, as they do occur, rather whether there are sufficient procedures in place to address the conflicts when they occur.

***Congress should continue their oversight and look for ways to ensure that the policies and procedures used to mitigate the potential conflicts of interest are effective, and that the recommendations made are transparent enough to protect investors and enhance the capital markets.***

### *Errors in Reports*

As with the conflicts of interest, there are also differing views on the amount of errors proxy advisory firms commit in their analyses and therefore, what effect, if any, they have on shareholder decisions. ISS indicates that they track errors in their reports and found that the error rate is less than 1%.<sup>53</sup> Moreover, a significant portion of the errors are not “errors” but rather differences of opinion over subjective analysis and methodology. ISS claims to engage year-round with S&P 500 companies and gives draft reports to some issuers 20 days in advance.<sup>54</sup> ISS also gives their clients alerts, through their Proxy Alert platform, about relevant errors in their reports. However, the U.S. Chamber of Commerce (“Chamber”) has indicated that 3,700 public companies do not have the ability to interact with ISS regarding errors.<sup>55</sup> The Chamber also argues the error rate is likely closer to 2.5% at a minimum, given that not all issuers file subsequent reports with the SEC documenting the errors.<sup>56</sup> In addition, the number of issuers that are requesting meetings with proxy advisors has declined noticeably, even though the error rate has not. There is clearly a disagreement on the actual numbers and types of errors.<sup>57</sup> However, when tens of thousands of proposals are voted on every year, even a small percentage of errors could have a profound effect on the information that is used to cast votes.

***Given the direct and indirect influence that proxy advisor recommendations can have and the fact that successive administrations have disagreed on how that influence should be addressed regulatorily, Congress should develop a way for issuers to be able to review and correct errors in proxy advisors’ reports so that investors have accurate information in which to make voting decisions. If there is a disagreement about the error, an investor should be able to know what the disagreement is based on. Lastly, engagement on a proxy advisor’s error should not be related to a company’s market capitalization.***

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<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> See Letter to the SEC from Ken Bertsch, Executive Director, Council of Institutional Investors (CII) (“we would expect that there are other undocumented errors”); available at: <https://www.sec.gov/comments/4-725/4725-6357861-196392.pdf>.

<sup>57</sup> On Jan. 27, 2020, BPC hosted “[The Proxy Process Reformed](#),” a discussion of the previously proposed Proxy Rules for Voting Advice. We had panelists from Institutional Shareholder Services, Inc. (ISS) and the U.S. Chamber.

### *Automatic and Robo-Voting*

Automatic voting occurs when a proxy vote is based on a client's predetermined criteria to vote on certain issues. Robo-voting is the process by which voting occurs seemingly in response to the release of a proxy advisor's recommendation. While some of the largest institutional investors expend significant resources to evaluate both management and shareholder proposals, there is a concern that not all asset managers conduct proper oversight of their proxy voting decisions and instead outsource that analysis to proxy advisors.

Proxy advisors regularly assert that their recommendations are only intended to be a supplemental tool used in voting decisions. However, the data appears to show that a significant number of shares are "robo-voted" soon after a proxy advisor's recommendation has been released. This concerning issue is amplified when recommendations are based on erroneous data coupled with the limited amount of time issuers are given to correct errors and the need for investment managers to align voting with fiduciary considerations.<sup>58</sup>

ISS claims that pre-populated ballots, associated with automatic voting, are based on custom reports, as opposed to their benchmark reports. Therefore, their clients have already predetermined how they will vote on many of the issues covered in the proposal process. Clients are the ones who determine what criteria they use to vote, and ISS conducts an annual review of the policies for their benchmark reports.

However, groups such as the Chamber argue that the process is not sufficiently robust to address the magnitude of the problem. According to one report, up to 20% of voting occurs in substantial numbers within three of a proxy advisor's report.<sup>59</sup> If there are substantial errors in the reports, votes would be based on inaccurate information, which in some cases could have profound effects on maintaining the fiduciary duty asset managers owe to their clients. Moreover, with the use of pre-populated votes based on a predetermined set of criteria, there may be insufficient time to change one's vote if an erroneous report is relied upon.

***While automatic voting with pre-populated votes saves investors time, the issue is whether there are sufficient safety mechanisms in place to "alert" investors of potential errors in reports before those votes are automatically submitted. Disabling the automatic function of submitting pre-populated votes, when there has been an objection raised, certainly seems like it would help ensure that errors in reports and subsequent recommendations are not able to have a negative multiplier effect on the outcome of any given vote. While there is circumstantial evidence that robo-voting occurs and in significant numbers to warrant review, the real question is whether there is a practical solution. Congress should continue working on practical solutions to this problem.***

### **Historic Bipartisanship on Reforming the Proxy Process**

Proxy advisory reform, which had been contemplated by the SEC for more than a decade, has had bipartisan congressional support. This support goes back to at least the 114th Congress with the passage of H.R.5311<sup>60</sup> co-sponsored by Representative John Carney (D-DE) and former Representative Sean

<sup>58</sup> Placenti, Frank M., "Are Proxy Advisors Really a Problem?" *American Council for Capital Formation (ACCF)* (October 29, 2018); available at <https://accf.org/2018/10/29/are-proxy-advisors-really-a-problem/>

<sup>59</sup> *Id.*

<sup>60</sup> H.R.5311 "Corporate Governance Reform and Transparency Act of 2016," (114<sup>th</sup> Congress 2015-16); available at

Duffy (R-WI) with the support from eight other Democrats. In the 115th Congress, H.R.4015 was co-sponsored by Representatives Gregory Meeks (D-NY) and Sean Duffy (R-WI) and passed the House with support from six Democrats.<sup>61</sup> After former SEC Chair Jay Clayton indicated his intent to promulgate rules on proxy advisors, Representatives Meek sand Duffy sent a joint letter asking the SEC to consider the concerns of transparency, accuracy, and conflicts of interest which were addressed in H.R.4015. After noteworthy changes to the SEC’s 2020 proposal—as a result of input from proxy advisors, institutional investors, and academics—the final rule<sup>62</sup> was finalized along with additional guidance<sup>63</sup> in July of 2020. *It was widely considered a compromise rule.* It should be noted that ISS immediately filed a lawsuit and in November of 2021, current SEC Chair Gary Gensler proposed amendments to the 2020 rule. Chair Gensler's amendments were adopted by the SEC on July 13, 2022.<sup>64</sup> However, the National Association of Manufacturers (NAM) sued the SEC challenging the 2022 rule revision. On June 26, 2024, the Fifth Circuit Court of Appeals vacated the 2022 rule, and the SEC did not appeal.<sup>65</sup>

While different administrations have taken slightly different approaches to these issues, one consistent aspect has been a bipartisan desire to address the proxy process. There have also been several Republican and Democrat appointed SEC commissioners that have supported reforming the proxy process including additional oversight over proxy advisory firms.

- Former SEC Chair Mary Jo White (2013-2017) statement at the SEC 2013 roundtable that she was “particularly interested in the discussion of conflicts of interest that may or may not arise in connection with the participation of proxy advisers in our system.”<sup>66</sup>
- Former SEC Chair Mary L. Schapiro (2009-2012) led the 2010 concept release which identified issues with proxy advisors.<sup>67</sup>
- Former SEC Commissioner Luis A. Aguilar (2008-2015) statement at the SEC 2013 roundtable indicating that the SEC “noted certain potential concerns relating to the activities of proxy advisors, including among other things the potential effects on shareholders of any conflicts of interest by the proxy advisory firm ... It is reasonable to ask if such actual or potential conflicts of interest can be effectively cured by disclosure and by efforts to insulate proxy advisory recommendations from a firm’s consulting business.”<sup>68</sup>

<https://www.congress.gov/bill/114th-congress/house-bill/5311/cosponsors?s=3&r=5&q=%7B%22search%22%3A%5B%22H.R.5311%2B114th%22%5D%7D>

<sup>61</sup> H.R.4015 “Corporate Governance Reform and Transparency Act of 2017,” 115<sup>th</sup> Congress 2017-18); available at <https://www.congress.gov/bill/115th-congress/house-bill/4015?q=%7B%22search%22%3A%5B%22H.R.4015%22%5D%7D&s=5&r=8>

<sup>62</sup> SEC “Exemptions from the Proxy Rules for Proxy Voting Advice” (effective Nov. 2, 2020); available at <https://www.sec.gov/rules/final/2020/34-89372.pdf>

<sup>63</sup> SEC “Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers” (effective Sept. 3, 2020); available at <https://www.sec.gov/rules/policy/2020/ia-5547.pdf>

<sup>64</sup> SEC Press Release, “SEC Adopts Amendments to Proxy Rules Governing Proxy Voting Advice” (July 13, 2022); available at <https://www.sec.gov/news/press-release/2022-120>

<sup>65</sup> *NAM vs SEC*, U.S. Court of Appeals for the 5<sup>th</sup> Circuit, No. 22-51069, (Jun. 26, 2024); available at <https://www.ca5.uscourts.gov/opinions/pub/22/22-51069-CV0.pdf>

<sup>66</sup> Chair Mary Jo White, “Welcoming Remarks at Proxy Advisory Services Roundtable” (Dec. 5, 2013); available at <https://www.sec.gov/news/public-statement/open-meeting-statement-2013-12-06-mjw>

<sup>67</sup> SEC’s “Concept Release on the US Proxy System” (Release Nos. 34-62495; IA-3052; IC-29340; File No. S7-14-10) (2010); available at <https://www.sec.gov/rules/concept/2010/34-62495.pdf>

<sup>68</sup> SEC Commissioner Luis Aguilar Statement “Looking at Proxy Advisory Firms from the Investor’s Perspective,” (Dec. 5, 2013), available at <https://www.sec.gov/news/public-statement/open-meeting-statement-2013-12-05-laa>

- Former SEC Commissioner Roel Campos (2002-2007) participated in a November 2019 BPC event indicating that “proxy advisors have a problematic business model”<sup>69</sup> with regards to their conflicts of interest.
- Former SEC Chair Elise Walter (2012-2013) participated in a February 2019 BPC event and signaled an openness to technical fixes regarding proxy advisors.<sup>70</sup>
- Former SEC Commissioner Joe Grundfest (1986-1990) indicated in a 2019 *Economist* article that he was supportive of giving issuers the opportunity to challenge the factual basis of recommendations.<sup>71</sup>

There has also been a long and distinguished list of bipartisan legislators who have supported proxy advisor reform over that past decade.

- In the 114<sup>th</sup> Congress, former Representative and current Governor John Carney co-sponsored H.R. 5311 the “Corporate Governance Reform and Transparency Act of 2016.”<sup>72</sup>
- In the 115<sup>th</sup> Congress, Senator Jack Reed (D-RI) led the bipartisan Senate legislation with five cosponsors, including former Senators Heidi Heitkamp (D-ND) and Doug Jones (D-AL), on S.3614 the “Corporate Governance Fairness Act.”<sup>73</sup>
- In the 116<sup>th</sup> Congress, 12 Democratic members of Congress, including Senators Krysten Sinema (I-AZ) and Senator Jacky Rosen (D-NV) who at the time was a member of the House, voted for H.R. 4015 the “Corporate Governance Reform and Transparency Act of 2017.”<sup>74</sup>
- In addition, 10 Republican members of Congress cosponsored the “Corporate Governance Reform and Transparency Act of 2019” in support of reforming the proxy process.<sup>75</sup> Moreover, along with the 12 Democrats previously cited, 226 congressional Republicans supported H.R. 4015, the “Corporate Governance Reform and Transparency Act of 2017”<sup>76</sup> also dealing with reforming the proxy process and oversight of proxy advisors.

<sup>69</sup> BPC’s event “The Role of a Corporation: The Shareholder versus Stakeholder Debate” (Nov. 19, 2019); available at <https://bipartisanpolicy.org/event/the-role-of-a-corporation-the-shareholder-versus-stakeholder-debate/>

<sup>70</sup> BPC’s event “Corporate Governance’s Increasing Role in Public Policy: Opportunities and Limitations” (Feb. 7, 2019); available at <https://bipartisanpolicy.org/event/corporate-governances-increasing-role-in-public-policyopportunities-and-limitations/>

<sup>71</sup> The Economist, “Proxy advisers come under fire” (Nov. 14, 2019); available at <https://www.economist.com/business/2019/11/14/proxy-advisers-come-under-fire>

<sup>72</sup> H.R.5311, “Corporate Governance Reform and Transparency Act of 2016” (114<sup>th</sup> Congress, 2015-16); available at <https://www.govtrack.us/congress/bills/114/hr5311/cosponsors>

<sup>73</sup> S.3614, “Corporate Governance Fairness Act” (115<sup>th</sup> Congress, 2017-18) (Sens. Reed (D-RI); Perdue (R-GA); Heitkamp (D-ND); Tillis (R-NC); Jones (D-AL); and Kennedy R-LA); available at: <https://www.congress.gov/bill/115th-congress/senate-bill/3614?q=%7B%22search%22%3A%5B%22Corporate+Governance+Fairness+Act%22%5D%7D&r=1>

<sup>74</sup> H.R.4015, “Corporate Governance and Transparency Act of 2017” (115<sup>th</sup> Congress, 2017-18); (Members of Congress: Cooper (D-TN); Cuellar (D-TX); Delaney (D-MD); Foster (D-IL); Gottheimer D-NJ); Himes (D-CT); Meeks (D-NY); Peters (D-CA); Peterson (D-MN); Rosen (D-NV); Sinema (D-AZ); Suozzi (D-NY)); available at <https://clerk.house.gov/Votes/2017702>

<sup>75</sup> H.R.5116, “Corporate Governance Reform and Transparency Act of 2019” (116<sup>th</sup> Congress, 2019-20) (Members of Congress: Steil (R-WI); Wagner (R-MO); Riggelman (R-VA); Barr (R-KY); Gooden (R-TX); Budd (R-NC); Rose (R-TN); Timmons (R-SC); Hill (R-AZ); Hollingsworth (R-IN)); available at <https://www.congress.gov/bill/116thcongress/house-bill/5116/cosponsors?r=2&s=1>

<sup>76</sup> H.R. 4015, “Corporate Governance Reform and Transparency Act of 2017” (115<sup>th</sup> Congress)(Dec. 20, 2017); available at <https://clerk.house.gov/Votes/2017702>

## Conclusion

Unfortunately, with the politicization of ESG and the SEC's guidance and rulemaking process, a thoughtful regulatory framework has been transformed into a political game of Ping-Pong. Given the vested interest in protecting investors and ensuring regulatory certainty, Congressional action is warranted.

I truly appreciate the opportunity to share some of what I have learned over the last few years at the BPC as well as my ongoing research into these important, complex, and dynamic issues. I will continue to facilitate discussions and work to identify problems and importantly bipartisan solutions in the capital markets. I fully believe in the strength and longevity of bipartisanship solutions.

Sincerely,

*Timothy M. Doyle*

Timothy M. Doyle

Founder & Principal  
Doyle Strategies, LLC