Securities Regulation Daily Wrap Up, TOP STORY—Commissioner Jackson tells Rep. Maloney institutional investors block corporate political spending disclosures, (Nov. 20, 2019)

Securities Regulation Daily Wrap Up

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"The legislation described in your letter, by requiring public companies to disclose how they spend shareholder money on politics, would help investors hold executives accountable when they engage in corporate political spending," wrote SEC Commissioner Robert Jackson.

SEC Commissioner Robert Jackson wrote to Rep. Carolyn Maloney (D-NY) that institutional investors are largely to blame for the lack of disclosure about public companies' political spending habits, a type of disclosure that he said is "overwhelmingly popular with ordinary investors." Commissioner Jackson has publicly supported corporate political spending disclosures since before he joined the Commission, for example, by signing a 2011 petition urging the Commission to issue political disclosure rules. Jackson recently responded to a letter from Rep. Maloney that had asked Jackson to comment on the House version of the proposed Shareholder Protection Act of 2019 following a hearing on ESG issues held by a House Financial Services Committee subcommittee chaired by Rep. Maloney.

Shareholder Protection Act. The Shareholder Protection Act (H.R. 4491), sponsored by Rep. Tom Malinowski (D-NJ)—and not to be confused with another bill by the same title dealing with increasing the resubmission thresholds for shareholder proposals (See H.R. 3088)—would impose new disclosure requirements on companies, institutional investors, and exchanges. "Until we can overturn the Citizens United decision, the least we can do is to empower shareholders to know and control their companies' political spending," said Malinowski in a press release announcing the introduction of the bill.

Specifically, the Shareholder Protection Act would require any proxy solicitation, consent, or authorization to describe several things about a company's upcoming fiscal year: (1) the specific nature of any proposed spending on political activities (if known to the company) and (2) the total amount to be spent on political activities. The company also would have to provide for approval of such spending by a majority of the company's outstanding shares. Violations of the provision would constitute a breach of fiduciary duty by company officers and directors and could result in joint and several liability of three times the amount of the company's spending on political activities.

The bill also would require stock exchanges to adopt listing standards that bar the listing of a company's shares if the company lacks a bylaw requiring board approval of political spending in excess of $50,000 and that would result in spending of more than $50,000 on a "particular" election. Moreover, institutional investors would have to disclose how they voted on companies' political spending authorizations, although a safe harbor would protect institutional investors that invest in or divest the shares of companies because of those companies' political spending activities.

Senator Bob Menendez (D-NJ) introduced mirror image legislation in May of 2019 (See S. 1630). "Shareholders – not corporate executives – should be making the call about whether or not they want their money spent on political campaigns," Sen. Menendez said in a press release.

Commissioner Jackson's response. In response to Rep. Maloney's letter, Jackson reiterated his backing for Congressionally mandated disclosure of corporate political spending. He cited two general trends in this area: (1) corporate leaders now can spend in a manner that conflicts with investors' interests; and (2) institutional

investors, which vote large blocks of public company shares, tend to vote against shareholder proposals that would require disclosure of companies' political spending habits.

With respect to institutional investors, Jackson said in a footnote that he did not fault them for adhering to any legal obligations they have to vote shares but that they should nevertheless make additional efforts to inform investors about how investors' savings will be impacted by votes on corporate political spending. According to Jackson, 70 percent of "ordinary American investors" want companies to disclose their political spending (citing a study conducted by Mason-Dixon Polling & Research).

Jackson also cited a study he conducted in 2013 showing that just eight institutional firms, acting as intermediaries for individual investors, were responsible for votes on $1.5 billion in corporate political spending. Jackson noted that while federal election laws mandate some corporate disclosures, election laws are not aimed at protecting investors. He also observed that election laws address only federal disclosures and would not include information about how companies spend on state political activities.

Moreover, Jackson said his office recently examined data on institutional investors' votes on executive compensation and political/lobbying spending, with emphasis on the four largest institutional investors. Jackson said institutions diverged on how they voted in these two areas. According to Jackson, votes on executive compensation tended to vary significantly, in part, because of the company-specific nature of executive pay. By contrast, Jackson said three of the four firms examined rarely, if ever, voted in favor of proposals to require political spending disclosures. He also noted that votes on political spending disclosures tended not to vary much, something he suggested was odd because disclosure should vary based on a company's circumstances.

Jackson also compared the four studied institutional investors' voting records on political spending with their proxy voting guidelines. Jackson singled out Vanguard for having never voted in favor of political spending disclosures despite having voted on more than 800 such proposals. Jackson went further and said the data at least suggested that Vanguard has an unstated policy of voting against political spending disclosure proposals.

Jackson concluded that the legislation referenced by Rep. Maloney "would" aid investors. "Without an SEC rule in this area, investors have filed shareholder proposals at hundreds of public companies demanding transparency of corporate political spending. Those proposals are overwhelmingly popular with ordinary investors," said Jackson. "But the institutions who manage millions of American families' savings vote to keep corporate political spending in the dark on a one-size-fits-all basis—without making that clear to investors."

The context for Rep. Maloney's letter. Representative Maloney sent her letter to Commissioner Jackson shortly after the House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, which she chairs, held a hearing on ESG issues and proposed legislation, including a bill addressing corporate political spending. The hearing itself tended to focus on climate change disclosures, but statements from key lawmakers and several of the witnesses underscored the divide between traditional financial disclosures under federal securities laws and specialized social disclosures, a divide perhaps sharpened by disclosures required by the Dodd-Frank Act. Some lawmakers and witnesses spoke generally about ESG matters, while others explicitly commented on political spending.

According to Rep. Maloney, ESG includes political spending by public companies. She suggested that investors "overwhelmingly" want ESG disclosures and that companies with good ESG track records tend to perform better financially. She also said that materiality alone is insufficient and that the SEC mandates disclosure of many things that are not based on the concept of materiality.

James Andrus, Investment Manager-Financial Markets, Sustainable Investment, California Public Employees' Retirement System (CalPERS), said in prepared remarks that he supports the Shareholder Protection Act. He said now-retired U.S. Supreme Court Justice Anthony Kennedy implied in his majority opinion in *Citizens United* that Congressional action could follow the court's holding regarding the constitutionality of corporate political donations. Degas A. Wright, CEO of Decatur Capital Management, Inc., also told lawmakers in written testimony that "[b]ased on our research, we have found that political contributions, as a proxy for political risk, is material in making investment decisions."

Subcommittee Ranking Member Bill Huizenga (R-Mich) began his opening statement by quoting several comments by SEC Commissioner Hester Peirce in which she suggested the letters "ESG" are scarlet letters not unlike the scarlet letter made famous by Nathaniel Hawthorne's work *The Scarlet Letter* and by repeating a quip from Peirce in another setting that "ESG" should be understood to mean "enabling shareholder graft." For Rep. Huizenga, the touchstone is materiality such that companies should focus on meaningful, material disclosures that a reasonable investor needs to make informed decisions.

Former SEC Commissioner Paul Atkins, CEO of Patomak Global Partners, referencing the seventh Congressional finding in the proposed Shareholder protection Act (stating shareholder votes on political spending would create accountability) said in prepared remarks: "Given the current disclosures and data available, it is not clear where the accountability is lacking." Atkins also said that shareholders historically have rejected shareholder proposals that would require corporate disclosures of political and lobbying expenses.

"Shareholders United." Representative Jamie Raskin (D-Md) has proposed legislation that would, like the Shareholder Protection Act, seek to resolve the institutional investor problem regarding political spending disclosures. As a result, the bill would allow corporate political donations only if a company has in place a procedure to assess the preferences of its shareholders. However, this requirement would not be met if a majority of the company's shares are held by investors who are barred by law from expressing political views.

Retired Delaware Supreme Court Chief Justice Leo E. Strine, Jr. also has written, as part of a recent sustainable capitalism proposal, that a public company should be barred from making political expenditures unless those expenditures are approved by 75 percent of the company's shareholders. Previously, Strine had praised some ESG efforts by the "Big 4" institutional investors (the same firms cited by Jackson in his letter to Rep. Maloney), but criticized these firms for their "fiduciary blind spot" regarding corporate political spending.

Recent legislative proposals and academic papers beg the question of where SEC policy may be headed. The SEC recently proposed amendments to the regulations governing shareholder proposals that would increase the eligibility requirements and would raise the resubmission thresholds. The SEC also has recently proposed to further regulate proxy advisory firms, the firms that often publicize recommendations on how institutions should vote on shareholder proposals, such as ESG issues (both the House and the Senate also have proposed legislation in this area within the last several years).

With respect to ESG matters more directly, SEC Chairman Jay Clayton recently told the agency's Investor Advisory Committee, with a nod to Mark Carney, governor of the Bank of England, that ESG issues should be considered in light of "'decision-useful' information," which Clayton equated with material information.

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