[Securities Regulation Daily Wrap Up, PROXIES—Roundtable panelists offer contrasting views on the use of shareholder proposals to improve engagement, (Nov. 20, 2018)]

Securities Regulation Daily Wrap Up

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By Amanda Maine, J.D.

Participants at the SEC’s recent roundtable on the U.S. proxy system clashed over reforming the shareholder proposal process as a means to improve company engagement with shareholders. Representatives from industry groups expressed support for raising the thresholds for the submission of proposals, while investor advocates praised the current system as a low-cost method of engaging with issuers.

Threshold issue. Under Rule 14a-8, a shareholder who has held $2,000 or 1 percent of a company’s stock for one year may submit a proposal to be included in the company’s proxy statement for a vote by all shareholders. The threshold was last raised in 1998, from $1,000. Maria Ghazal of Business Roundtable said that the $2,000 threshold is too low and should be increased. Ideas that could be considered by the Commission include tying ownership to the length of the holding period and allowing for a reduced threshold for long-term holders, tiering ownership thresholds based on the size of the company, and requiring a filing fee for shareholder proposals, Ghazal suggested.

Tom Quaadman of the Chamber of Commerce’s Center for Capital Markets Competitiveness advised that the decline in the number of public companies from 20 years ago is evidence that the public company system is not working, and the shareholder proposal process may have contributed to this decline. Quaadman advocated revisiting the thresholds for submitting reproposals to cut down on the number of "zombie proposals"—proposals that have been submitted multiple times without ever reaching a majority vote—that clog up communication channels between the company and shareholders and impose a cost on the company and investors. "At some point in time, we have to realize that is why companies are deciding not to go public," Quaadman said.

Brandon Rees of the AFL-CLO said that the idea that companies are not going public because of shareholder proposals is "preposterous." According to Rees, the average publicly listed company can expect a shareholder proposal about once every 7.7 years. Rees said that the shareholder proposal rules are in place to democratize the process so it is accessible to small investors. Large shareholders do not need to submit a shareholder proposal to get the company’s attention, he said.

Jonas Kron of Trillium Asset Management agreed with Rees, stating that the quality of one’s idea doesn’t depend on the size of one’s ownership. The ownership threshold is meant to demonstrate a shareholder’s "skin in the game," and for some investors, $2,000 is skin in the game. According to Kron, shareholder proposals make up less than 2 percent of proxy ballot items, less than 4 percent were filed with companies with under $1 billion in market capitalization, and less than 9 percent of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal. It is a very well-functioning system, and so-called zombies are not "clogging it up," Kron said.

Aeisha Mastagni of CalSTRS also questioned whether the discussion involved creating a solution to a problem that does not exist. The current system works and has appropriate balances for both issuers and investors, according to Mastagni. Noting that the SEC has finite resources, she wondered if they would be better spent on improving the mechanics of the proxy voting system instead.

ESG issues. Some participants raised the issue of using the shareholder proposal process to advocate for social change, or ESG (environmental, social, governance) issues. According to Dannette Smith, senior deputy general counsel at UnitedHealth Group, in many instances the shareholder process has turned into voting on social issues raised by a shareholder with no long-term interest in the company, and the board does not understand why they are forced to spend time on these issues. Quaadman agreed, stating that social proposals now make up about 50 percent of shareholder proposals, and they never pass. However, Rees said that mainstream investors are increasingly recognizing that environmental and social issues are important drivers of value creation because they matter to company performance.

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