Securities Regulation Daily Wrap Up, PROXIES—CII, others call foul over late DERA data on shareholder proposals, (Sept. 9, 2020)

Securities Regulation Daily Wrap Up

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The CII and other signatories said data not included in the Commission's proposing release, but added later to the public file by DERA, is critical because it suggests a much more draconian impact on investors' ability to submit shareholder proposals.

The Council of Institutional Investors and other signatories, in the several weeks leading up to a long-scheduled September 16, 2020 Commission open meeting on whether to adopt controversial changes to the shareholder proposal framework, has submitted yet another set of comments to the Commission, this time calling foul over a late data submission to the public file by the SEC's Division of Economic and Risk Analysis (DERA). The CII requested that the Commission re-open the public comment period to allow for consideration of DERA's submission, which appears to suggest a much greater impact on investors than was implied by analyses contained in the proposing release.

What it's all about. The CII's latest public comment requires some background about the SEC's shareholder proposal proposing release and DERA's economic analysis contained in that release. The proposed changes to the SEC's shareholder proposal submission framework have roots that go back as far as the early 1990s when the Commission proposed, but never adopted, changes that would have, for example, raised the resubmission thresholds somewhat beyond the latest proposed levels to levels akin to those in the now-defunct, Republican-led Financial CHOICE Act.

But the current proposal addresses much more than just the resubmission thresholds. The following summarizes at a high level the key differences between current practice and the proposing release:

- **Eligibility—**Current: Continuously hold $2,000 or 1 percent for one year; Proposed: Continuously hold $2,000 for 3 years/$15,000 for 2 years/$25,000 for 1 year.
- **Aggregation to meet eligibility requirement—**Current: Yes; Proposed: No.
- **Resubmission thresholds—**Current: 3/6/10 percent; Proposed: 5/15/25 percent.
- **Proposals per meeting—**Current: One proposal per meeting; Proposed: One proposal per meeting, but also would clarify that a shareholder may not rely on others' securities holdings to meet eligibility requirements or to submit multiple proposals.
- **Representatives—**Current: Follow state law procedures to attend shareholder meeting; Proposed: Disclose seven items of information about the proponent and the proponent's representative.

DERA analyses. The economic analysis included in the proposing release began with an acknowledgement: "We are sensitive to the economic effects that may result from the proposed rule amendments, including the benefits, costs, and the effects on efficiency, competition, and capital formation."

From here, the proposing release used the current regulatory framework for shareholder proposals as its baseline. With respect to the impact of the proposal on all participants in the shareholder proposal process, DERA analysis suggested the following key findings:

- **Affected companies—**Total of 18,584 (5,746 registered per Exchange Act Section 12; 12,718 management companies; 120 companies voluntarily submitting proxy materials) (data measured as of December 31, 2018, except for data on management companies, which was measured as of August 31, 2019).
- **Affected proponents—**Total of 170; 38 individuals; 132 institutions.

- **Ratio of proponents to investors—**3:1,000,000.
- **Data for 1997-2018—**(1) Total shareholder proposals of 20,804 (lowest year 745; highest year 1,136); (2) Large companies get the most proposals, but proposals declined over time for both large and small companies; (3) Governance proposals declined in number while environmental and social proposals increased in number; (4) More proposals were submitted by institutions than individuals; and (5) Voting support increased for environmental and social proposals.

On August 14, 2020, DERA Director and Chief Economist, S.P. Kothari, at SEC Chairman Jay Clayton's request, submitted to the public comment file a "preliminary draft analysis" of a data set compiled by Broadridge Financial Solutions, Inc. and which DERA first requested in July 2019, nearly six months before the Commission's proposing release, and had analyzed preliminarily as of October 4, 2019. A footnote states that Broadridge declined to be identified as the source of the data until June 2020. Kothari noted that the proposing release stated that SEC staff may submit additional materials to the public comment file at a later date. The first page of the proposing release, as it appeared in the *Federal Register*, does state: "We or the staff may add studies, memoranda, or other substantive items to the comment file during this rulemaking."

The data set includes five-years' worth of shareholder proposal data. According to DERA's cover letter, however, DERA examined the Broadridge data and concluded that: (1) it used different eligibility tiers from what would become the proposing release ($3,000/5 years; $15,000/3 years; $25,000/1 year—see the above comparison of the current and proposed eligibility requirements); (2) account ownership was unclear; (3) it was difficult to tell if securities had been held continuously; and (4) the data might not reflect the impact of the proposing release on the small number of shareholders who account for most shareholder proposals. Ultimately, Kothari concluded that the Broadridge data was "not relevant" to the central question of whether the proposing release would produce fewer votes on shareholder proposals.

The preliminary analysis contained in Appendix A to the August 14, 2020 DERA letter was even more specific: "our statistics are based on retail holdings and they exclude holdings by institutional investors; (ii) we lack data on shareholders' ownership duration in excess of two years; (iii) the overall distribution of ownership of retail accounts may be different from the distribution of ownership for a subset of shareholders who are likely to submit shareholder proposals; and (iv) the U.S. retail ownership data is account-level data, and we assume that each account corresponds to one retail investor, but in fact each retail investor can hold multiple accounts and multiple retail investors can hold a single account."

The most recent DERA analysis suggests several headlines:

- "We estimate that in 22%-55% of all companies (an increase in 9%-42% from the baseline) and 2%-15% of S&P 500 companies (an increase in 1%-14% from the baseline), ***less than 5% of accounts would be eligible to submit a shareholder proposal under the proposed amendments***" (emphasis added).
- "[W]e estimate that in 82%-99% of all companies (an increase in 38%-55% from the baseline) and 59%-99% of S&P 500 companies (an increase in 52%-93% from the baseline), ***less than a quarter of accounts would be eligible to submit shareholder proposal under the proposed amendments***" (emphasis added).

CII comments. The CII's latest comment on revisions to the SEC's shareholder proposal framework highlights that the new DERA preliminary analysis of the Broadridge data shows that the proposed rule changes would have much greater impact on investors (especially retail investors) than was indicated in the proposing release. The CII cites SEC guidance on economic analysis to the effect that such analyses must be a "fair assessment" of the regulatory options and that confidentiality of the source of data (Broadridge initially declined to be identified as the source) provided to the Commission may not a basis for excluding data from a rulemaking release. According to CII, the delayed public release of the data and the potentially much greater impact on investors it suggests as compared to the analysis previously disclosed in the Commission's proposing release counsel in favor of extending the public comment period, but they also demonstrate, in the CII's view, how the proposing release "is a casebook example of an arbitrary and capricious rule."

The CII observed that the proposing release acknowledged the potential for different impacts from the shareholder proposal amendments on retail and institutional investors. The CII said that despite the different tiers used by Broadridge and its inability to look beyond two years of continuous holding, such data would still be relevant for at least investors who held their securities for two or fewer years, although the proposing release's impact would remain the most significant for investors who have held their securities for fewer than three years.

The CII also disputed what it said was DERA's implied assumption that shareholders who have never exercised their right to submit a shareholder proposal would not miss such rights if the proposed changes are adopted. The CII said this reasoning elided the fact that rights remain valuable, even if they are not exercised.

The CII has submitted comments on the shareholder proposal proposing release five other times. Initially, the CII asked the Commission to extend the comment period from 60 to 120 days. In later comments, the CII provided additional analysis backing its concerns about the proposing release, citing the economic harm that could ensue if the amendments are adopted substantially as proposed, and citing data showing that shareholder proposals had declined since 2015 while voting support had risen for the proposals that have been submitted to companies. On balance, the CII asserted that its analysis indicated that the current shareholder proposal framework was working and does not need to be amended (See CII comments: July 29, 2020; May 19, 2020; January 30, 2020; November 22, 2020; November 15, 2020). CII representatives also have meet with Chairman Jay Clayton, twice with Commissioner Roisman (the lead commissioner on the SEC's proxy reforms), Commissioner Allison Herren Lee, and the SEC's Investor Advocate.

Companies: Broadridge Financial Solutions, Inc.

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