

## [Securities Regulation Daily Wrap Up, TOP STORY—Divided Commission votes to propose changes to rules governing proxy advisory firms, shareholder proposals, \(Nov. 5, 2019\)](#)

Securities Regulation Daily Wrap Up

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The commissioners voting in favor of the proposals heralded them as long overdue changes in a market that has evolved substantially since the last rule amendments, while the dissenters maintained that adopting the amendments would benefit corporations at the expense of shareholders.

In a three-to-two vote, the SEC voted to publish for comment two proposals that, if adopted, would make several changes to Commission rules affecting proxy advisory firms and the shareholder proposal process. The proxy advisory firm proposal would require that businesses that provide proxy voting advice furnish their advice to issuers to review for factual errors or methodological weaknesses before providing the report to the firm's clients. It would also require the disclosure of material conflicts of interest and amend Rule 14a-9 to include examples of misleading proxy voting advice (*Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice*, [Release No. 34-87457](#), November 5, 2019; *Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8*, [Release No. 34-87458](#), November 5, 2019).

The second proposal would amend the thresholds for eligibility to submit shareholder proposals as well as shareholder proposal resubmissions. While retaining the \$2,000 securities holding threshold for eligibility to submit shareholder proposals, the proposal would create a tiered system where shareholders holding a greater value of securities in a company would be subjected to a shorter holding period than those with smaller holders to encourage shareholder engagement by long term investors. It would also provide a "time out" for proposals that are resubmitted and continually fail to get support from other shareholders.

Chairman Jay Clayton [praised](#) the proposals, stating that they are rooted in two essential aspects of effective regulation—modernization and retrospective review. The marketplace has changed, and the SEC's proxy rules have not kept up, he said. He emphasized that the proposals are just that at this stage—proposals. "We welcome and encourage comment, analysis, including analysis supported by data, and direct engagement," he implored, adding that it is time to move on from a debate in the abstract on proxy issues to constructive engagement on actionable proposals. He added that the Commission will also consider in the future other proxy system related issues, including universal proxy and "proxy plumbing."

**Proxy advisory firms.** Under the proposed [amendments](#) regarding proxy advisory firms, firms relying on exemptions from the information and filing requirements of SEC's proxy rules would be subject to certain conditions. A firm would be required to give registrants an opportunity to review and provide feedback on proxy voting advice before it is issued to the firm's client to identify factual errors, incompleteness, or methodological weaknesses in the firm's analysis. Clayton advised that registrants that file their proxy materials less than 25 days before the annual or special meeting would not be able to take advantage of the review process.

Corporation Finance Director William Hinman noted that some proxy advisory firms already share this information with issuers, but sometimes it is only available to the largest companies or those that pay a fee for it. The amended rules would give smaller issuers the same opportunity as the larger ones. He added that nothing in the proposal would require firms to change their voting advice based on issuer feedback. Commissioner Hester Peirce agreed that all registrants, not just the biggest companies, should be able to flag errors in a proxy advisor's report.

The proposed amendments would also require the disclosure of material conflicts of interest in any proxy voting advice. Commissioner Elad Roisman, who was [tasked](#) with leading the proxy reform effort, [noted](#) that it has been 27 years since the proxy solicitation rules were last amended, and the market has changed since then. "Material conflicts of interest of a proxy voting advice business should be readily ascertainable to those utilizing their advice," he advised.

In addition, the proposed amendments would specify the circumstances under which a person who furnishes proxy voting advice will be deemed to be engaged in a solicitation and codify the SEC's view that voting advice provided in response to an unprompted request would not constitute a solicitation. Finally, the proposal would amend Rule 14a-9—the proxy antifraud rule—to include examples of when the failure to disclose certain information in a proxy report could be considered misleading.

**Shareholder proposals.** The [proposal](#) to revise the regulations regarding shareholder proposals and resubmissions would use a tiered approach for the thresholds required for a shareholder be eligible to submit a proposal for inclusion with the company's proxy materials. While the amendments would keep the long-standing \$2,000 minimum ownership threshold, it would require continuous ownership of the securities for at least three years before the shareholder could submit a proposal. Shareholders with continuous ownership of at least \$15,000 would be eligible after two years, and eligibility would attach after one year of continuous ownership of at least \$25,000 of a company's securities. The proposal would also eliminate the alternative threshold of 1 percent of a company's securities.

According to Commissioner Roisman, the revisions to the shareholder proposal thresholds strike an appropriate balance by ensuring that a shareholder has some meaningful "economic stake or investment interest." "By measuring shareholders' stakes in the company by not only money invested, but also by how long they have held their shares, we preserve the intent of the rule but keep the proposal process open to those who cannot afford a great monetary investment," Roisman explained.

Roisman also [advised](#) that the shareholder proposal process was intended to facilitate shareholder engagement with companies. The ownership thresholds were last amended in 1998, and there are now cheap and easy ways to communicate with management, directors, and other shareholders through the internet and social media, he pointed out.

The proposal would also revise the levels of shareholder support a proposal must receive in order for it to be eligible for resubmission at the same company. If a shareholder proposal has been previously voted on three or more times in the last five years, a company would be allowed to exclude it from its proxy materials if the proposal received less than 50 percent of the votes cast and experienced a decline in shareholder support of 10 percent or more compared to the immediately preceding vote. These proposals would be subject to a "time out," Clayton explained. He added that the proposed resubmission changes would not apply to all proposals that fail, just those that repeatedly fail by more than 75 percent.

Roisman added that the resubmission thresholds have not been changed since 1954. The Commission's proposed amendments only exclude those proposals that have been overwhelmingly rejected by shareholders in the past, Roisman assured.

The resubmission proposal would also amend the current "3-6-10" percent thresholds to "5-15-25" percent thresholds. That is, under the amendments, a proposal would need to achieve support by at least 5 percent of the voting shareholders to be eligible for submission in the following three years. Proposals submitted two and three times in the past in the prior five years would need to achieve 15 percent and 25 percent support, respectively, in order to be eligible for resubmission the following three years.

"If a shareholder cannot get more than 1 in 20—or 5 percent—of its fellow shareholders to support its proposal in the first year, or more than 1 in 4 shareholders after three years of proxy inclusion, it should be required to take a time out," Clayton proclaimed.

**Dissents.** Commissioners Robert Jackson and Allison Herren Lee respectfully but strenuously dissented from approving the proposals. If adopted, the changes would limit the ability of investors to hold corporate insiders

accountable, Jackson [said](#). Regarding the proxy advisor proposal, Jackson decried that proxy advisory firms that recommend a vote against executives must now give their analysis to management, include executives' objections in their final report, and risk federal securities litigation over their methodology. He criticized the proposal for "interfering in decades-long relationships between investors and their advisors in a way that will significantly skew voting recommendations toward executives."

Turning to the proposed amendments on shareholder proposal thresholds, Jackson criticized the release for assuming that high levels of support indicate a "good" proposal, and lower levels of support indicate a "bad" proposal. He advised that his staff had examined what kind of investor initiatives would be excluded if the proposed amendments had been in place in the past and found that they would have removed key CEO accountability measures from the ballot. He also criticized the proposal for not studying how to address the impact of so-called "gadfly" shareholder proposals brought by the 10 most frequent individual submitters each year. Instead of undertaking a study to examine this impact, the proposal adopts "pro-management changes that swat a gadfly with a sledgehammer," Jackson protested.

Commissioner Lee [echoed](#) several of Jackson's objections to the proposals, including the notion that they would shift powers away from shareholders and towards management. According to Lee, studies show that a vote recommended by management carries the day 90 percent of the time, and the Commission's proposal would tilt the balance even further towards management.

Lee also criticized the proposal's requirement for issuer review of proxy advice, stating that there is no basis for assuming that greater issuer involvement would improve proxy voting advice. She added that the proposal does not provide shareholder proponents the same opportunities to review the recommendations that it would require for issuers.

On the shareholder threshold proposal, Lee pointed to several corporate governance reforms—such as majority vote rules for the election of directors, staggered board terms, limits on poison pills, and proxy access bylaws—that originated from shareholder proposals. Shareholders have also been active in seeking better climate change disclosures, she advised.

Like Jackson, Lee found the lack of data to predict the effects of the proposed change troubling. She noted that the median portfolio of a Main Street investor is \$27,000, so these retail investors would have to hold nearly all their securities in one company (which is not recommended) or wait three years to have the same eligibility to submit proposals as those who can afford to invest \$25,000 compared to \$2,000 under the proposed thresholds. "With each aspect of today's two proposals, the odds are stacked against shareholders, and that is why I cannot support them," Lee concluded.

The releases are [No. 34-87457](#) and [No. 34-87458](#).

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