Statement of Chairman Jay Clayton on Proposals to Enhance the Accuracy, Transparency and Effectiveness of Our Proxy Voting System

Chairman Jay Clayton

Nov. 5, 2019

Good morning. This is an open meeting of the U.S. Securities and Exchange Commission, under the Government in the Sunshine Act.

Today we have two items on the agenda. These items are part of the Commission's ongoing work to enhance the accuracy, transparency and effectiveness of our proxy voting system. They reflect the considerable experience of our staff. In 2018, almost 5,700 proxy materials were filed with the Commission, and the staff in the Division of Corporation Finance received more than 250 no-action requests relating to shareholder proposals.

Today's proposals are both rooted in key principles of our securities law. First, materiality. The proposals are designed to ensure investors receive the material information that would be expected to affect their investment decisions (including voting decisions).[1] Second, facilitating constructive, information-rich engagement among shareholders and issuers in a manner that benefits all shareholders and our public capital markets more generally.[2]

Today's proposals also are rooted in two essential aspects of effective regulation—modernization and retrospective review. In today's proposals, we have examples of why modernization of regulation, including to adjust for market developments and advances in technology, is critical. Twenty years ago, the business of providing proxy voting advice was virtually non-existent. Today, there are thousands of investment advisers managing trillions of dollars in assets for our retail investors, and many of these investment advisers contract with businesses to provide proxy voting advice, which is subject to our proxy rules. Several of these proxy voting advice businesses are large and multi-faceted.[3] Their services to investment advisers, and their effect on shareholder engagement and our capital markets more generally, are comparable to the services of other significant third-party market participants on whom shareholders rely, including auditors, rating agencies and research analysts.[4]

These market developments require our attention.

Similarly, in the area of shareholder proposals, the resubmission requirements—how much support a shareholder proposal needs to be included in the next year's proxy—and other procedural requirements

have not been updated for decades.[5] Resubmission thresholds were last amended in 1954—65 years ago. In that time, our markets have changed dramatically. For example, the retail / institutional shareholder split has flipped from 90% retail / 10% institutional in 1950, to 20% retail / 80% institutional in 2017.[6] In addition, communications technology, including, importantly, the ability to engage with companies (including at the board level), other shareholders and other parties, has moved from print and three-day (maybe a week) mail to instant communications with broad, costless dissemination and instant access and contact. Much of this is the result of advances in technology, but some is attributable to the Commission's work to foster and improve shareholder engagement, for example Regulation FD.

Modernization and retrospective review of the Commission's rules in these areas of our shareholder engagement ecosystem are clearly overdue. The Treasury Department, in its 2017 report on our capital markets, reached the same conclusion.[7] Our proposals apply our commitment to craft rules designed to ensure all investors receive a common mix of information that is (1) accurate and (2) includes the information that would reasonably be expected to affect an investment decision.

Now, before we discuss today's first proposal with specificity, I will provide some context. I note that today's actions (1) are proposals—we welcome and encourage comment, analysis, including analysis supported by data, and direct engagement, and (2) are one more step in our ongoing effort to modernize the proxy process.

I will briefly summarize those efforts. Last fall, following initiatives that go back decades, SEC staff hosted a roundtable that brought together investors, issuers and other market participants who raised many issues in this area. While I heard a wide range of views, it was clear to me that there was significant interest in modernizing the proxy process. As a result of the roundtable, we received almost 300 unique comment letters and helpful suggestions to improve our proxy voting system. Some of the letters that struck me the most came from long-term Main Street investors, including an Army veteran[8] and a Marine veteran,[9] a police officer,[10] a retired teacher,[11] a public servant,[12] a single Mom,[13] a couple of retirees who saved for retirement,[14] all of whom expressed concerns about the current proxy process.

A common theme in their letters was the concern that their financial investments—including their retirement funds—were being steered by third parties to promote individual agendas, rather than to further their primary goals of being able to have enough money to lessen the fear of "running out" in retirement or to leave money to their children and grandchildren. These letters are a helpful reminder that the issues the Commission grapples with in this area are not a matter of (1) shareholders versus companies or (2) businesses that provide proxy voting advice versus companies. These are false dichotomies. We must recognize that there is a myriad of investor interests and preferences. Many of these interests overlap substantially, such as the thirst for information material to an investment decision. But there are many others that do not and may be in direct conflict, such as a desire for a company to sell or buy a particular business or undertake a particular study or course of action. Understanding and responding to these interests, including both common and conflicting interests, in a fair and efficient manner is an import function of corporate governance and our proxy rules are intended to facilitate that function. Accordingly, our proxy process, in its components and as a whole, necessarily reflect the need for a rich exchange of information and the need to balance the interests of proponents of shareholder proposals with the interests of their fellow shareholders.

On August 21, 2019, the Commission took the first action to address these suggestions when it provided guidance to assist investment advisers in fulfilling their proxy voting responsibilities.[15] The Commission's guidance focuses on the responsibilities of investment advisers in the context of proxy voting on behalf of clients and clarifies how an investment adviser's fiduciary duty under the Advisers Act applies in that context, including if the investment adviser engages a proxy voting advice business.

In summary, the Commission's guidance noted, among other things, that:

1. where an investment adviser has assumed the authority to vote on behalf of its client, the investment adviser must make voting determinations consistent with its fiduciary duty; and
2. the extent to which an investment adviser takes on proxy voting responsibilities, if at all, may be shaped by agreement, provided that there is full and fair disclosure and informed consent.

Importantly, the guidance did not limit how investment advisers and their clients may agree to use the services of businesses that provide proxy voting advice. The guidance focuses on disclosure and includes principles fundamental to informed consent. For example, to the extent the investment adviser engages a proxy voting advice business, the full and fair disclosure of facts and circumstances of that engagement should capture information that would be material to the client in choosing the investment adviser.

In addition to this guidance, the Commission issued an interpretation that the proxy voting advice provided by these businesses generally constitutes a "solicitation" under the federal proxy rules and provided related guidance about the application of the proxy antifraud rule to proxy voting advice.[16]

The Commission staff—and many others—have been considering today's issues since at least 2010. It is time to move from debate in the abstract to constructive engagement on actionable proposals. We make that transition today.

Our work in this space will continue. Following today's proposals, I expect the Commission to address "proxy plumbing" and "universal proxy." Yes, I believe the "proxy plumbing" and the proxy card also are in need of modernization and retrospective review and have instructed the staff to prepare recommendations in these areas. So, more to come.

Proxy Voting Advice — Enhancing Transparency, Improving Disclosures of Material Conflicts, and Increasing Confidence in the Proxy Process

The first item in our agenda today is a continuation of that work and, at its core, is focused on improving the accuracy and transparency of the disclosure provided to investment advisers and, in turn, their clients regarding the facts and circumstances of the engagement of the proxy voting advice business. More specifically, the proposal would facilitate and enhance the quality of disclosure about material conflicts of interest. This proposed requirement is consistent with a key principle of our disclosure based regulatory system—conflicts that would be material to an investment decision should be disclosed.[17] The proposal also would provide an opportunity for a brief period of review and feedback through which registrants will be able to identify any factual errors or methodological weaknesses in the proxy voting advice and proxy voting advice businesses would have an opportunity to amend and supplement their reports to the extent they believed necessary, if at all.

I am proud of the staff's thoughtful approach to this proposal and, in particular, that it takes into account the timing constraints during the busy proxy season. For example, we expect that registrants that would like to take full advantage of the proposed review process would, in the majority of cases, need to file their proxy materials earlier than they do today. Proxy materials filed earlier mean more time for the analysis done by the businesses providing the proxy voting advice, more opportunity for engagement, and better disclosure for investors. Significantly, 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. In these cases, there would be no required change to the issuer engagement process used by businesses that provide proxy voting advice.

I would like to thank Commissioner Roisman for his leadership as we consider these improvements to the proxy voting system. In light of his efforts on the two items that we will consider today, I will turn it over to Commissioner Roisman to provide his opening remarks. I'll then ask Bill Hinman, our Director of

the Division of Corporation Finance, and S.P. Kothari, our Chief Economist and Director of the Division of Economic and Risk Analysis, for the staff's presentation of the first recommendation. Following the staff's presentations, I'll ask Commissioner Jackson, Commissioner Peirce and Commissioner Lee for any remarks, and then I'll provide some closing thoughts.

Before I turn it over to Commissioner Roisman, I would like to thank and acknowledge the following members of the staff that contributed to this effort:

- From the Division of Corporation Finance: Bill Hinman, Michele Anderson, Ted Yu, Luna Bloom, Daniel Greenspan, and Rob Cowan.
- From the Division of Economic and Risk Analysis: S.P. Kothari, Narahari Phatak, Vlad Ivanov, Xanthi Gkougkousi, and Dan Deli.
- From the Office of General Counsel: Bryant Morris, Dorothy McCuaig, Jacob Loshin, and Shaz Niazi.
- From the Division of Investment Management: Paul Cellupica, Tara Varghese, Holly Hunter-Ceci, David Bartels, and Adam Bolter.

So without further ado: Commissioner Roisman.

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Shareholder Proposals — Modernizing Resubmission Requirements and Facilitating Shareholder Engagement

As I said earlier, the first item in our agenda is intended to enhance the accuracy and transparency in our proxy system. The second item in our agenda is directed at modernizing and enhancing the efficiency of one key component of our proxy system.

Rule 14a-8 allows shareholders to have their proposals included in the company's proxy statement and to be considered and voted on by shareholders with little cost to the shareholder proponent. This is a significant benefit for the shareholder proponent; without this accommodation, that shareholder would need to conduct a separate proxy solicitation in compliance with the federal proxy rules that would be costly for the proponent. The rule was intended to facilitate meaningful engagement between companies and proposing shareholders, for the benefit of all shareholders. It was not, however, intended to empower a few shareholders to repeatedly impose the direct and indirect costs of pursuing a proposal that has garnered very little support, costs that are borne by all shareholders. It is a uniquely American, tailored mechanism for shareholder-company engagement on matters of import to shareholders. Many other important markets do not have a mechanism with such wide access.[18] It is not however, intended to be a forum for debate of issues that are not, at least at the time, of import to a very substantial majority of shareholders.

The shareholder proposal rule and, in particular, its resubmission thresholds is ripe for modernization and retrospective review, as it has been several decades since its last significant revision. In today's world of (1) ubiquitous communications, (2) businesses that provide proxy voting advice, and (3) a high ratio of institutional holdings, the ability of a proposing shareholder to engage with registrants and make their views known to their fellow shareholders has changed significantly. If a shareholder cannot get more than 1 in 20—or 5%—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. Said another way, if after three attempts at a proposal within a 5 year period, 75% of your fellow shareholders still do not support your proposal, you should take a time out. Keep in mind that "time out" does not mean that the shareholder proposal cannot come up again in the future or cannot be made at a different registrant. And, the "time out" does not apply to all proposals that fail year after year. A proposal that fails by a wide margin year after year, can be resubmitted year after year, so long as at

least 25% of shareholders support the proposal and it is potentially on a path toward more meaningful shareholder support.

Similarly, it is clear to me that a system in which five individuals accounted for 78% of all the proposals submitted by individual shareholders[19] would benefit from greater alignment of interest between the proposing shareholders and the other shareholders—who hold more than 99% of the shares. Yes, you heard that right, five individuals accounted for 78% of all the proposals submitted by individual shareholders.

Today's proposed amendments have been carefully crafted to more appropriately balance the benefits and burdens to all shareholders, while, importantly, retaining the ability of small, medium- and long-term shareholders to continue to enter and engage in the shareholder proposal process. For example, today's proposal would not impact the ability of long-term shareholders to submit a proposal as the recommendation does not seek to increase the $2,000 dollar submission threshold for shareholders who have held their shares for more than three years. For those shareholders with shorter-term holdings, the proposed amendments would be tiered to appropriately tailor the dollar thresholds.

The proposal would also encourage proponent-issuer engagement at an early stage of the process. Finally, I want to make it clear that the shareholder proposal rule never has been, nor would it be under the proposed amendments, a way to regulate the merits of any shareholder proposal topic.

Before I turn it over to Commissioner Roisman, I would like to thank and acknowledge the following members of the staff that contributed to this effort:

- From the Division of Corporation Finance: Bill Hinman, David Fredrickson, Tamara Brightwell, Matt McNair, Luna Bloom, Daniel Greenspan, and Lisa Kohl.
- From the Division of Economic and Risk Analysis: S.P. Kothari, Hari Phatak, Xanthi Gkougkousi, Olga Itenberg, Andrew Glickman, Vlad Ivanov, Wei Liu, and Andy Kim.
- From the Office of General Counsel: Bryant Morris, Jacob Loshin, Dorothy McCuaig, Omid Harraf, and Shaz Niazi.
- From the Division of Investment Management: David Bartels and Raymond Be.

Now I will turn it over to Commissioner Roisman to provide his opening remarks.

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[1] *See TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.…Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."). *See also Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

[2] *See, e.g.*, Securit[ies] and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce, 78th Cong., 1st Sess., at 17-19 (1943) (Statement of the Honorable Ganson Purcell, Chairman, Securities and Exchange Commission) ("We give [a stockholder] the right in the rules to put his proposal before all of his fellow stockholders along with all other proposals … so that they can see then what they are and vote accordingly.… The rights that we are endeavoring to assure to the stockholders are those rights that he has traditionally had under State law, to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have his proposal voted on."). But the Commission has expressed recurring concern over the years that the shareholder proposal rules are susceptible to misuse. In 1948, the Commission adopted three new bases for exclusion to "relieve the management of harassment in cases where [shareholder] proposals are submitted for the purpose of achieving personal ends rather than for the common good of the issuer and its security holders." *See* Notice of Proposal to Amend

Proxy Rules, Release No. 34-4114 (July 6, 1948) [13 FR 3973 (Jul. 14, 1948)], at 3974 ("1948 Proposing Release"). In 1953, the Commission amended the shareholder-proposal rule to allow companies to omit the name and address of the shareholder-proponent to "discourage the use of this rule by persons who are motivated by a desire for publicity rather than the interests of the company and its security holders." *See* Notice of Proposed Amendments to Proxy Rules, Release No. 34-4950 (Oct. 9, 1953) [18 FR 6646 (Oct. 20, 1953)], at 6647. In 1983, when amending the criteria for determining whether a proposal constitutes a resubmission that could be excluded, the Commission noted that commenters "felt that it was an appropriate response to counter the abuse of the security holder proposal process by certain proponents who make minor changes in proposals each year so that they can keep raising the same issue despite the fact that other shareholders have indicated by their votes that they are not interested in that issue." *See* Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Release No. 34-20091 (Aug. 16, 1983) [48 FR 38218 (Aug. 23, 1983)], at 38221 ("1983 Adopting Release"). In addressing the personal-grievance basis for exclusion in 1982, the Commission noted that "[t]here has been an increase in the number of proposals used to harass issuers into giving the proponent some particular benefit or to accomplish objectives particular to the proponent." *See* 1982 Proposing Release, at 47427.

[3] As rough indicators of the growth and size of these types of businesses, it has been reported that Institutional Shareholder Services ("ISS") has had a series of owners and was acquired in 2006 for $550 and last acquired in 2017 for over $700 million. As of June 2019, ISS had more than 1,800 employees in 30 offices in 13 countries. Glass Lewis, which reportedly was acquired in 2007 for $46 million, had more than 360 employees in the U.S., the United Kingdom, Ireland, Germany, and Australia as of June 2019. Both ISS and Glass Lewis are private companies and comprehensive financial and operational information is not publicly available.

[4] Each of these professions and advisory businesses is subject to rigorous conflict management rules, including rules that go beyond disclosure.

[5] *See* Adoption of Amendments to Proxy Rules, Release No. 34-4979 (Jan. 6, 1954) [19 FR 246 (Jan. 14, 1954)]. Other procedural requirements, including the initial submission thresholds, were last substantively updated in 1998. *See* Amendments to Rules on Shareholder Proposals, Release No. 34-40018 (May 21, 1998) [63 FR 29106 (May 28, 1998)].

[6] *See* Marcel Kahan and Edward Rock, *Embattled CEOs*, 88 Tex. L. Rev. 987 (2010).

[7] *See* U.S. Department of the Treasury, *A Financial System that Creates Economic Opportunities: Capital Markets* (Oct 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[8] *See* https://www.sec.gov/comments/s7-24-16/s72416-178628.htm.

[9] *See* https://www.sec.gov/comments/s7-24-16/s72416-4963462-178646.pdf.

[10] *See* https://www.sec.gov/comments/4-725/4725-5953957-189187.pdf.

[11] *See* https://www.sec.gov/comments/4-725/4725-5340483-184028.pdf.

[12] *See* https://www.sec.gov/comments/4-725/4725-5395773-184167.pdf.

[13] *See* https://www.sec.gov/comments/s7-24-16/s72416-5003248-182886.pdf.

[14] *See* https://www.sec.gov/comments/s7-24-16/s72416-183006.htm.

[15] *See* Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5325 (Aug. 21, 2019) [84 FR 47420 (Sept. 10, 2019)].

[16] *See* Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019) [84 FR 47416 (Sept. 10, 2019)].

[17] *See, e.g.,* Item 404 of Regulation S-K [17 CFR § 229.404].

[18] The proposed shareholder thresholds would still make it significantly easier for a shareholder to submit a proposal in the United States than in most European countries where shareholders are required to own between 0.5% and 5% of a company in order to be able to submit a proposal. *See* Maximilian Horster, and Kosmas Papadopoulos, Climate Change and Proxy Voting in the U.S. and Europe, Harvard Law School Forum on Corporate Governance and Financial Regulation (Jan. 7, 2019), *available at* https://corpgov.law.harvard.edu/2019/01/07/climate-change-and-proxy-voting-in-the-u-s-and-europe/.

[19] Nickolay Gantchev & Mariassunta Giannetti, The Costs and Benefits of Shareholder Democracy 8–9, 37 (European Corporate Governance Institute, Working Paper No. 586/2018, 2018).