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SEC Set To Tackle Shareholder Proposal, Proxy Reg Revisions

By **Tom Zanki**

Law360 (June 13, 2019, 8:35 PM EDT) -- The U.S. Securities and Exchange Commission is considering changing the thresholds for submitting shareholder proposals and amending regulations that could affect proxy firms, potentially tackling two hot-button corporate governance topics that some lawyers say are ripe for action.

What the changes may look like is unclear, but securities and capital markets attorneys anticipate some proposals in the next year, given recent additions to the agency's regulatory agenda.

The SEC, in a semiannual agenda filed with the federal Office of Management and Budget, said in late May that it is considering amending decades-old rules that determine how shareholders can submit and resubmit items for votes at annual meetings. The agency also said it may propose amending rules regarding the use of proxy advisers, but provided little detail.

In each case, the SEC's notice said it expects to propose rules for public comment by April 2020.

"It is a sign that the commission is going to move sooner rather than later," said Dechert LLP partner Harry Pangas. "It is signaling to folks that it is something they are really serious about."

The "Reg Flex Agenda," which is short for the Regulatory Flexibility Act that requires federal agencies to identify rulemaking projects under development, is not binding. But SEC Chairman Jay Clayton has said in past speeches that he wants to sharpen its focus to reflect actions the agency reasonably expects to complete.

The new corporate governance topics are consistent with the current focus at the SEC, which last November hosted roundtables inviting market participants to debate shareholder proposals and related proxy matters.

Mayer Brown LLP partner Michael Hermsen noted that policies on shareholder proposals and proxy advisory firms have generated controversy for years and "have not been updated for a long time."

"The existing rules were written in a different time and environment," said Hermsen, who represents issuers and investment banking firms on equity and debt offerings, as well as companies on corporate governance matters.

Depending on one's perspective, updating rules in these areas could make public markets more attractive, a priority under Clayton in an era where fewer companies are going public. At the same time, investor groups worry shareholders could get shortchanged.

Business interests for years have sought changes to shareholder proposal rules, arguing that "zombie" proposals — or ballot items that have been repeatedly rejected — continue appearing on ballots because of outdated rules that make it too easy to resubmit them. The U.S. Chamber of Commerce's Center For Capital Markets sees such proposals as draining company resources.

"You have repetitive proposals that get declining support," said Tom Quaadman, the center's executive vice president.

The SEC's notice says little about which direction it is leaning, though Commissioner Elad Roisman said in a March speech that he is interested in whether raising resubmission thresholds would better preserve company management's time and shareholder money.

The current policy for resubmitting shareholder proposals, developed in 1954, requires a proposal to gain at least 3% support to be submitted again if voted on once; at least 6% to submitted again if voted on twice; and at least 10% if voted on three times.

Quaadman argues the resubmission thresholds should be raised, given that retail shareholders, who tend to own smaller stakes individually, owned most U.S. stock when the current rules took effect. That dynamic has now been reversed, as institutional shareholders own most stock.

"You need to have resubmission thresholds that make sense for that," Quaadman said.

The Council for Institutional Investors, however, opposes raising the thresholds, arguing it could make it more burdensome to submit shareholder proposals, which it sees as a key tool for investors to hold company management accountable and communicate with one another.

CII deputy director Amy Borrus noted that many corporate governance best practices, such as requiring directors up for election to gain a majority of votes even when running uncontested, originated as shareholder proposals. She pointed to data that says shareholder proposals only account for 2% of all voting items at company annual meetings.

"There is little evidence that the current volume of shareholder proposals is that burdensome," Borrus said.

The SEC may also review rules for submitting a shareholder proposal for the first time. To get an item on the ballot, an investor must hold a company's stock for at least one year and own at least $2,000 of stock — a figure that was enacted in 1998 and hasn't been adjusted for inflation — or 1% of that company's stock.

In terms of how rule revisions may affect proxy advisory firms, it's not clear what the SEC has in mind. Proxy firms sell advice to asset managers and shareholders on how to vote in corporate elections, including on controversial topics like acquisition proposals or executive pay.

The SEC's agenda says that its Division of Trading Markets is considering recommending that the commission propose amendments involving proxy solicitation exemptions under Rule 14a-2(b), which advisory firms have relied on to avoid being subject to SEC proxy rules and related disclosure and filing requirements.

The SEC declined to comment beyond the description filed with OMB. Needless to say, lawyers will be watching closely to see whether the SEC plans to subject proxy advisers to additional regulation.

“It feels like the SEC is getting ready to do something,” GableGotwals counsel Jeffrey Haughey said. “What that something is remains to be seen. It seems to be focused on conflicts of interest and transparency.”

Business groups have lobbied for more oversight on proxy firms on grounds that Institutional Shareholders Services Inc. and Glass-Lewis & Co., the industry’s dominant providers, have outsize influence over corporate elections but do little to disclose their methodologies or mitigate conflicts of interest.

The Milken Institute, an economic think tank, added to calls for more oversight of proxy firms like ISS and Glass Lewis in a report published Thursday, arguing that lack of competition and oversight makes their recommendations “vulnerable to conflicts of interest and ideological bias.”

ISS stresses that it is already a registered investment adviser with the SEC, and its general counsel Steven Friedman said in a statement that the federal Investment Advisers Act and “related SEC rules to which we are subject provide a mature and comprehensive regulatory regime that covers virtually every aspect of ISS' business and subjects us to oversight by the [SEC].”

“Further, as a fiduciary, ISS is committed and fully obligated to fulfilling our duty of loyalty and care, and to providing timely, accurate and insightful shareholder voting research and analysis to our clients,” Friedman said.

Glass Lewis, which is not a registered investment adviser, did not respond to requests for comment.

However the SEC proceeds on shareholder proposals and proxy regulation, lawyers note that any rulemaking will be subject to public comments, a potentially time-consuming process. Pangas said changes to the shareholder proposal rules, which are covered under the SEC’s Rule 14a-8, may be more ripe for action.

“I think the fix for 14a-8 is a lot more straightforward than what do you do with the proxy solicitation exemptions for proxy advisory firms,” Pangas said.

--Editing by Philip Shea and Alanna Weissman.