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Meridian Client Update

SEC Chair Announces Staff Review of Proxy Process

On July 30, 2018, Securities and Exchange Commission (SEC) Chair Jay Clayton announced that the SEC staff will be holding roundtable discussions with investors, public companies and other market participants about whether the SEC's proxy rules should be refined.

The last time that the SEC engaged in a wholesale review of the proxy rules was in 2010, at which time the SEC issued a concept release seeking public comment on whether the U.S. proxy system as a whole operates with the accuracy, reliability, transparency, accountability and integrity that shareholders and public companies should expect. However, the SEC did not implement any substantive reforms as a result of this effort. It remains to be seen whether the planned roundtable leads to more meaningful reforms to the proxy rules than the 2010 effort.

Chair Clayton has asked the SEC staff to consider the following topics when developing the agenda for the roundtable discussions.

Shareholder Proposals (e.g., Proposals to Separate the Board Chair and CEO Roles)

Areas of the shareholder proposal process that may warrant particular attention include:

- Whether the current thresholds for minimum ownership¹ (e.g., shares held and length of time) to submit a proposal to be included in the company's proxy statement appropriately consider the interests of all shareholders, taking into account the potential benefits to shareholders of a proposal (or resubmission) being considered or adopted, as well as the costs associated with the inclusion of a proposal (or resubmission) in the proxy statement.
- Whether rules that allow companies to omit resubmitted proposals that received less than 3%, 6% or 10% of the vote, depending on how many times the subject matter has been voted on in the last five years, are appropriate.
- Whether meaningful ownership in the company can be demonstrated by factors other than the amount invested and the length of time shares are held.
- Whether the voices of long-term retail investors (who invest directly and indirectly through mutual funds, ETFs and other products) are appropriately represented in the shareholder proposal process and in the shareholder engagement dynamic more generally.

¹ Currently, to be eligible to submit a shareholder proposal under the proxy rules, a shareholder must own either \$2,000 or 1% of a company's stock for one year.

Proxy Advisory Firms

Areas regarding proxy advisory firms that may warrant particular attention include:

- Whether investment advisers to funds and other clients are relying on proxy advisory firms for information aggregation and voting recommendations to a greater extent than they should due to legal requirements or other factors.
- Whether the extent of reliance on the advice of proxy advisory firms is in the best interests of investment advisers and their clients, including funds and fund shareholders.
- Whether issuers are being given an appropriate opportunity to raise concerns if they disagree with a proxy advisory firm's recommendations, including, in particular, if the recommendation is based on erroneous, materially incomplete or outdated information.
- Whether there is sufficient transparency about a proxy advisory firm's voting policies and procedures so that companies, investors and other market participants can understand how the proxy advisory firm reached its voting recommendations on a particular matter.
- Whether there are conflicts of interest, including with respect to related consulting services provided by proxy advisory firms and, if so, whether those conflicts are adequately disclosed and mitigated.
- The appropriate regulatory regime for proxy advisory firms and whether prior SEC staff guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms should be modified, rescinded or supplemented.
- Whether comparisons of vote recommendations across similarly situated companies have value.

Voting Process

Areas of the voting process that may warrant particular attention include:

- Potential for over-voting and under-voting of securities by broker-dealers, and the reasons this may occur and ways to address it.
- Practical difficulties in confirming whether an investor's shares have been voted in accordance with the investor's instructions.
- Costs and challenges associated with distributing proxy and other materials to beneficial owners who hold in "street name," as well as the costs and other challenges of communicating with such shareholders more generally.

Retail Shareholder Participation

In the 2017 proxy season, retail shareholders voted approximately 29% of their shares, while institutional investors voted approximately 91% of their shares. Areas of retail shareholder participation that may be useful to better understand:

- Reasons for this relatively low retail participation rate and whether better communication and coordination among proxy participants, increased use of technology, changes to rules or investor education could increase participation.
- How existing rules or market practices affect the ability of individuals who invest in the public markets through investment vehicles, such as mutual funds and pension funds, to participate in the governance of public companies in which they have an interest.

- Whether relatively low retail investor participation should be of concern and should inform analysis of existing regulation.

Other Topic Areas

Chair Clayton also suggested that the SEC staff consider as part of the roundtable agenda the use of advanced technology in the proxy process and universal proxy cards that would include the names of all nominees in contested board of directors' elections.

Roundtable Details

The roundtable date, agenda items, panelists, moderators and logistical information will be made public as they are finalized.

Members of the public who wish to provide their views on the proxy process, either in advance of or after the roundtable, may submit comments electronically or on paper to the following addresses.

- *Electronic Comments:* Use the SEC's [Internet submission form](#) or send an email to rule-comments@sec.gov.
- *Paper Comments:* Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

Information that is submitted will become part of the public record and posted on the SEC's website.

Meridian comments. Below are Meridian's initial thoughts on Chair Clayton's proposed topics for the upcoming roundtable.

The requirements to include shareholder proposals on corporate proxy ballots remain a controversial issue. Since 2011, the SEC has taken certain limited actions with regard to the rules governing shareholder proposals.² However, both the U.S. Chamber of Commerce and the Business Roundtable have recommended extensive reform of the rules governing shareholder proposals.³ Representing investor interests, the Council of Institutional Investors (CII), Ceres Investor Network ("Ceres"), Interfaith Council on Corporate Responsibility ("ICCR") and the Forum for Sustainable and Responsible Investment ("US SIF"), among others, have each weighed in on the shareholder proposal process.⁴ The roundtable should generate lively discussion around this topic.

The proxy advisory firms remain a favorite target of Congress and corporate interests. On May 9, 2018, a Congressional committee sent letters to Institutional Shareholder Services and Glass Lewis seeking information regarding each proxy advisory firm's voting system, report inaccuracies and potential conflicts of interest. The letters also expressed concern about the proxy advisory firms' market concentration and significantly increased influence on shareholder voting. In addition, Congress has repeatedly attempted to

² In 2011, the SEC amended Rule 14a-8 to allow for shareholder proposals on proxy access. Since that time, the SEC staff has issued bulletins that address the circumstances in which companies may exclude shareholder proposals under the proxy rules. Through those staff bulletins, the SEC has modified how it applies its rules governing shareholder proposals.

³ In 2017, the U.S. Chamber of Commerce advocated for extensive reform of the rules governing shareholder proposals (see www.uschamber.com/press-release/us-chamber-offers-recommendations-sec-shareholder-proposal-reform). In 2016, the Business Roundtable also called for reforms of these rules (see www.businessroundtable.org/resources/responsible-shareholder-engagement-long-term-value-creation).

⁴ See, CII letter to the SEC (www.cii.org/files/August%202017%20SEC%20Letter.pdf); See Joint letter from CII, Ceres, ICCR and US SIF regarding rule 14a-8 to SEC Chair Clayton ([www.cii.org/files/November%202017%20cover%20letter%20to%20SEC%20final%20\(003\)%20\(002\).pdf](http://www.cii.org/files/November%202017%20cover%20letter%20to%20SEC%20final%20(003)%20(002).pdf)); Joint CII, Ceres, ICCR and US SIF letter to the Senate (www.cii.org/files/issues_and_advocacy/correspondence/2018/Ltr%20to%20Congress%20Regarding%20S%2020155.pdf) and "An Investor Response to the U.S. Chamber's Proposal to Revise SEC Rule 14a-8" (www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf).

subject proxy advisors to increased regulatory oversight. In 2017, Congress introduced two bills that would regulate proxy advisory firms – one that stalled in the Senate (the Financial CHOICE Act) and another that was referred to and currently sits in the Senate Banking Committee (the Corporate Governance Reform and Transparency Act). Despite the repeated efforts to regulate the proxy advisory firms, none of the legislative proposals have gained traction and we doubt the roundtable discussion will move the legislative needle on this issue. However, the SEC certainly could issue proposed rules in response to concerns raised during the roundtable discussion on the proxy advisory firms.

The reasons for Chair Clayton’s concerns regarding the integrity of the proxy voting process are not clear. In his statement, he did not cite to any specific study or comments by investors or public companies that suggest the proxy voting process is fraught with irregularities or should otherwise be subject to reform. It will be interesting to see if the roundtable discussions identify material issues associated with the proxy voting process.

Finally, Chair Clayton believes it would be beneficial to better understand why only a small proportion of retail shareholders participate in the proxy voting process. However, the SEC is fighting an uphill battle on this topic. One of the likely reasons that retail shareholders do not fully participate in the proxy voting process is indifference. To combat this indifference, the SEC may fashion solutions that prove costly and administratively burdensome to public companies. Further, an increase in proxy voting by retail investors introduces a potential wildcard in shareholder vote outcomes. Retail investors may display more idiosyncratic voting patterns than many mutual funds and other institutional investors.

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The **Client Update** is prepared by Meridian Compensation Partners’ Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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