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The Forum for Sustainable and Responsible Investment

Shareholder Rights Rulemaking Toolkit

SHAREHOLDER PROPOSAL PROCESS (RULE 14A-8) AND PROXY ADVISORS

DECEMBER 2019

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December 2019

On November 5th, 2019, the Securities and Exchange Commission (SEC) announced two proposed rules that will have an impact on how investors will be able to vote their proxies, engage with companies and hold management accountable. Together, these proposals shift power from investors to corporate management.

The first proposal makes changes to Rule 14a-8 of the Securities and Exchange Act of 1934 (1934 Act), which sets the parameters for the shareholder proposal process. The second proposal aims to further regulate proxy advisory firms and their ability to provide independent research, data and voting services to their clients under the 1934 Act.

This toolkit will provide you with background information about the proposed rules, talking points, an overview of the rulemaking process and additional resources. Most importantly, it includes two sample comment letters you can customize and submit to the SEC. We urge you to take the time to communicate with the SEC about Rule 14a-8 and changes to regulations governing proxy advisors. The closing date for the public comment period is February 3.

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Background

The shareholder proposal rule (Rule 14a-8) is a vitally important, market-based mechanism for shareholders to communicate with boards, management and other shareholders on important corporate governance risks as well as social and environmental issues that are not being properly addressed.

For decades, the shareholder proposal process has been one of the most visible and verifiable ways in which investors can practice responsible ownership. It provides shareholders' the ability to file resolutions at companies' annual meetings.

Rule 14a-8 was designed to protect investors, including those with limited stock holdings. The threshold to file shareholder proposals (currently $2,000 of shares held for one year) was intentionally set at a level to allow both individual and institutional shareholders to engage corporate boards and senior management.

In addition, the current rule allows resubmission thresholds that provide an opportunity for proposals to gain support over time. Proposals that required resubmission/multiple resubmissions to gain support have contributed to significant and tangible benefits at countless companies. For example, recent proxy access proposals (granting investors the right to nominate board directors to appear on the proxy) at Netflix, Citigroup and Cisco started in the single-digits but in subsequent years earned majority votes. Shareholder proposals also have contributed to such advances as independent boards of directors, say-on-pay vote requirements and adoption of global human rights principles. The proposed rule will make it significantly more difficult for investors to get critical issues on the meeting agendas of publicly traded companies.

Proxy advisory firms help investors meet their fiduciary responsibilities by providing efficient and cost-effective research services to help inform their proxy voting decisions. This proposed rule would require proxy advisory firms to give issuers the opportunity to review and comment on the proxy advice before it is issued. It would also allow issuers to include a link to the issuers' views when proxy advice is sent to recipients. These changes would increase costs to investors and delay the timely delivery of the reports to investors. It also potentially threatens the integrity of the proxy advice because it compromises the independence of the research.

What's in the Proposed Rules?

Rule 14a-8 - Shareholder Proposals

Ownership Thresholds

The proposal does away with the simple requirement that shareholders must hold at least $2,000 worth of company shares for one year to be eligible to file a shareholder proposal at its annual meeting. Instead, the proposed rule creates a new tiered system based on the length of time the shares are held. For shares held one year, the SEC proposes a massive 1200 percent increase in the stock ownership required—to $25,000. If held for two years, the amount is $15,000 and for three years, the level is $2,000.

No Aggregation of Shares

Historically, investors have been able to combine their holdings to meet the ownership threshold in order to file a resolution. The SEC proposal bars share aggregation while also imposing a huge increase in the ownership threshold for shares held less than two or three years.

Resubmission Thresholds

The support that shareholder proposals must receive—based on the percentage of the shares voted—to be eligible for resubmission historically has been set at modest levels to allow emerging issues to build broader support over time. The current thresholds necessary in order to resubmit are 3 percent of the shares voted the first year, 6 percent the second year and 10 percent the third year and beyond. The proposal raises these to 5 percent, 15 percent and 25 percent respectively.

The SEC also proposes an entirely new "momentum" provision that seems to seek to ensure that some of the proposals that successfully get more than 25 percent of the vote may not be able to be resubmitted. This provision allows a proposal to be omitted from the proxy if it reaches the 25-50 percent range after three years, but the proposal's support decreases by 10 percent from the previous year's vote. This sets up a possible illogical scenario where a proposal that loses support from 49 percent to 44 percent in the fourth year (a 10 percent decline from 49 percent) can be omitted, but a proposal that remains steady at 27 percent on the fourth year's vote can be resubmitted. The imposition of this rule would declare that a vote of 44 percent is a weaker outcome than a vote of 27 percent.

One-Proposal Limit

The proposed rule would not allow an investor or a representative to offer more than one shareholder proposal per meeting. A shareholder-proponent would not be permitted to submit one proposal in his or her name and simultaneously serve as a representative to submit a different proposal on another shareholder's behalf for consideration at the same meeting. An investment advisor with several clients with different concerns about the same company would be forced to make a difficult choice on which proposal to put forward.

Forced Engagement

The proposed rule would also mandate that the proponents make themselves available to the company for dialogue in person or by phone. For asset owner proponents who have hired asset managers or other representatives for their professional guidance and advocacy services, this represents an interference with the client/manager relationship. This portion of the proposed rule is a radical departure.

Proxy Advisor Rule

Issuer Pre-review of Proxy Advice

This rule mandates that proxy advisory firms give issuers (companies) an opportunity to review and provide feedback on proxy voting advice before proxy advisory firm clients get to see it. It also requires proxy advisory firms to include a link to an issuer's position paper if the issuer disagrees with the proxy advisory firm's conclusions. This is unprecedented interference with the ability to provide independent

research that investors rely on. It is also in direct contrast to the regulation of stock analyst reports. Those rules prohibit stock analysts from sharing draft research reports with target companies, other than to correct factual errors after approval from the firm's legal or compliance department.

Therefore, if the SEC adopts its proxy advisor regulation, a stock analyst and a proxy advisor could write a report on the same company and the stock analyst would violate securities laws by showing it to the company in advance, while the proxy adviser would violate the law if it did not show it to the company in advance.

Currently, the two predominant proxy advisory firms, ISS and Glass-Lewis, have an informal process to allow issuers to correct any factual inaccuracies in their reports.

Disclosure of Conflicts

The proposed rule includes a largely non-controversial provision that mandates that proxy advisors disclose material conflicts of interest in their voting advice.

Talking Points

Shareholder Proposals

- Rule 14a-8 is not broken, so why is the SEC trying to fix it? Shareholder proposals are a vitally important, market-based mechanism for investors to communicate with boards, management and other shareholders and stakeholders on important corporate governance, risk and policy issues affecting companies.

- On average, only 13 percent of Russell 3000 companies received a shareholder proposal in any one year between 2004 and 2017. In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years.

- Holding a diversified portfolio may conflict with higher filing thresholds. The current threshold requires a shareholder to maintain at least $2,000 in shareholdings in order to be able to file proposals. This places the opportunity for filing of shareholder proposals within reach of an individual with average holdings. However, increasing the amount of shares to be held would conflict with the ability of Main Street shareholders to maintain a diversified portfolio by requiring larger holdings in order to bring a proposal forward.

- The new submission thresholds will make it significantly more difficult for investors to get critical issues on the meeting agendas of publicly traded companies. Time and again, individual investors, asset managers and institutional owners have raised an array of concerns at American companies to improve companies and make them better investments over the longer term. They have encouraged companies to diversify their boards of directors, to align executive compensation incentives with the long-term good of the company, to manage human rights in the supply chain and to reduce their greenhouse gas emissions.

- Many proposals that garnered substantial support upon re-filing would have been excluded if the second and third-year thresholds were raised to 15% and 25%. Just among governance proposals from 2011 to 2018 this includes: six for an independent board chair (UMB Financial, American Express, AutoNation, Chevron, Wendy's and KeyCorp), twelve proposals seeking disclosure of political contributions or lobbying payments (Wynn Resorts, Allstate, Republic Services, Nike, FedEx, Express Scripts, Charles Schwab, IBM, Citigroup, Verizon, UnitedHealth Group and Devon Energy), three proposals urging One Share One Vote (Alphabet, United Parcel Service and Telephone and Data Systems). Shareholders who were prepared to support these proposals upon the re-filing would have been denied their rights to do so if re-filing thresholds had been increased, especially if third-year resubmission thresholds exceeded twenty percent.

- Additional data: The proposed rules would also exclude up to 35% of independent Chair shareholder proposals, 40% of proxy access proposals, 50% of board diversity proposals, and nearly 65% of report on climate change proposals, and 40% of political spending disclosure proposals. (https://www.sec.gov/news/statements/2019/jackson-data-appendix-on-proposals-to-restrict-shareholder-voting.pdf)

- Poorly performing proposals are already screened out by the current thresholds. In 2019 shareholders consistently provided less than 3% support to proposals seeking an ideological litmus test for board members at Discovery, Starbucks, Apple, Twitter and Amazon.

Shareholders at Exelon similarly rejected a proposal to "burn more coal" with only 1.6 percent support. Investors also rejected a request to report on how Gilead Sciences spent its share of the federal tax cut, a proposal that earned only 2.2%. These proposals would be barred from resubmission.

- Shareholder proposals raise issues before they erode shareholder value. This process is one of the most visible and verifiable ways in which investors can practice responsible ownership. A key element is to allow shareholders to raise issues before a crisis that erodes shareholder value arises.

- A substantial majority of large companies have sexual orientation nondiscrimination policies largely as a result of hundreds of shareholder proposals. A 2016 analysis by Credit Suisse found that 270 companies that provided inclusive LGBTQ work environments outperformed global stock markets by 3 percent annually for the previous 6 years.

- Significant changes to thresholds will lead to unintended consequences. Changes to ownership and resubmission thresholds will have unintended consequences that are costly and inefficient. Alternatives to shareholder proposals include voting against directors, lawsuits, books and records requests and requests for additional regulations. Each of these is more onerous and adversarial than including a 500-word proposal in the proxy statement for the consideration of shareholders.

- The job of the SEC is to protect investors. Making it more difficult for investors to file resolutions—and in some cases impossible to resubmit resolutions—doesn't protect investors, and in the long run, it will not help companies either.

Proxy Advisors

- The proxy advisor proposal will give corporate management substantial editorial influence over reports and recommendations on their companies. Proxy advisory firms help investors meet their fiduciary responsibilities by providing independent, efficient and cost-effective research services to inform their proxy voting decisions. It is inappropriate to give companies the automatic right to preview proxy advisory firm reports and to lobby the authors to change recommendations.

- Claims that proxy advisory firms wield excessive influence over how institutional investors vote and that institutional investors vote in lockstep with proxy advisor recommendations are not supported by the facts. While ISS recommended voting against say-on-pay proposals at 12.3% of Russell 3000 companies in 2018, just 2.4% of those companies received less than majority shareholder support on their say-on-pay proposals. In 2019, Glass Lewis recommended in favor of 89% of directors and 84% of say-on-pay proposals, while directors received average support of 96% and say-on-pay proposals garnered average support of 93%. These examples demonstrate that investors don't blindly follow proxy advisor recommendations. In fact, according to ISS, 85% of its top 100 clients use a custom voting policy.

The Rulemaking Process

1. A proposed rule is announced and voted on by the five commissioners. Both of these proposals passed with 3-2 votes. The proposed rule includes the length of the public comment period (30, 60, 90 or 120 calendar days). The 14a-8 proposed rule has a 60-day comment period ending on February 3. Many organizations, including US SIF, have written the SEC asking them to extend the comment period to 120 days.
2. Approximately 2-4 weeks after the vote, the proposed rule is published in the Federal Register, which starts the comment period clock. These two rules were published in the Federal Register on December 4.
3. Anyone can submit a comment. Submitted comments are **public** and posted on the SEC website under the rulemaking comment file.
4. On February 3, when the 60-day comment period ends, the SEC is obligated to review and consider each submission.
5. The SEC considers the comments and writes the final rule. There is no deadline for completing this step.
6. When the SEC has completed writing the rule, the five commissioners vote on the final rule. If passed, the rule becomes final and is enacted.
7. Legal challenges can occur once the rule becomes final, which may delay the implementation of the rule.

How to Submit Your Comment

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/concept.shtml); or
- Send an email to rule-comments@sec.gov. **Please include File Number S7-23-19 on the subject line 19 for the Shareholder Proposal rule**. **For the Proxy Advisor rule use File Number S7-22-19**.

Paper comments:

- Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-23-19 for the Shareholder Proposal rule. **For the Proxy Advisor rule use File Number S7-22-19**. This file number should be included on the subject line if email is used. You only need to file with one method.

Sample Letter – Rule 14a-8

[Firm letterhead]

Via email to rule-comments@sec.gov [or method you choose]

[Date]

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: Proposed Rule on Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8; File Number S7-23-19

Dear Ms. Countryman:

On behalf of FIRM_NAME, I welcome the opportunity to provide this comment letter on the "Proposed Rule on Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8," File Number S7-23-19.

[insert paragraph about your firm. Consider including what your firm does, your AUM (if you have AUM), what type of clients you serve, etc.]

The shareholder proposal process is one of the most visible and verifiable ways in which investors can practice responsible ownership. This proposed rule, by changing submission and resubmission thresholds, among multiple other alterations, will make it significantly more difficult for investors to get critical issues on the meeting agendas of publicly traded companies. The proposals, particularly the momentum rule and the prohibition of share aggregation, also increase the complexity of this process.

Investors—including the "main street individual investor" that the SEC has said is a priority—have a multi-decade history of raising critical issues at American companies. Such issues have included board diversity, executive compensation, reduction of greenhouse gas emissions and implementation of non-discrimination policies. These proposals help companies look at concerns before they become crises that erode shareholder value, increase reputational risk and harm communities.

The proposal transfers power to management at the expense of their shareholders. Investors have not sought these changes. Corporate trade associations and some issuers are advocating for these changes even though, on average, only 13 percent of Russell 3000 companies received a shareholder proposal in any one year between 2004 and 2017. In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years.

[Select specific proposed changes such as the momentum rule or increases in submission, resubmission thresholds, and share aggregation from the "What's in the Rule" section that you want to add to this letter. Discuss how it may affect your work or clients.]

The shareholder proposal process is one of the least costly ways of alerting companies and their investors to emerging issues, assessing shareholder perspectives and improving governance, disclosure, risk management, and performance. Alternatives to shareholder proposals include voting against directors, lawsuits, books and records requests and requests for additional regulations. Each of these is more onerous and adversarial than including a 500-word proposal in the proxy statement for the consideration of shareholders.

Rule 14a-8 is working for investors. The revisions put forward are unacceptable. The SEC should protect investors' ability to help hold publicly traded companies accountable rather than creating higher thresholds and more complex rules.

Thank you for your consideration of these comments.

Sincerely,

Name
Title

Sample Letter – Proxy Advisor

[Firm letterhead]

Via email to rule-comments@sec.gov [or method you choose]

[Date]

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: Proposed Rule on Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice; File Number S7-22-19

Dear Ms. Countryman:

On behalf of FIRM_NAME, I welcome the opportunity to provide this comment letter on the "Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice," File Number S7-22-19.

[insert paragraph about your firm. Consider including what your firm does, what your AUM (if you have AUM), what type of clients you serve.]

The proxy advisor proposal will give corporate management substantial editorial influence over reports on their companies because it requires proxy advisors to give companies the automatic right to preview their reports and to lobby the authors to change recommendations. Proxy advisory firms help investors meet their fiduciary responsibilities by providing independent, efficient and cost-effective research services to inform their proxy voting decisions.

By giving companies the automatic right to preview proxy advisory firm reports and to lobby the authors to change recommendations, this proposal fosters an inappropriate pro-management bias in proxy advisor reports. Company executives and their lobbyists want to make it harder and more expensive for institutional investors to get the expert advice they need to hold management accountable. This will make it less likely that investors vote against management or vote at all.

The proposed rule points to issuers' claim that proxy advisory firms wield excessive influence over how institutional investors vote and that institutional investors vote in lockstep with proxy advisor recommendations. This assumption is not supported by the facts. While ISS recommended voting against say-on-pay proposals at 12.3% of Russell 3000 companies in 2018, just 2.4% of those companies received less than majority shareholder support on their say-on-pay proposals. In 2019, Glass Lewis recommended in favor of 89% of directors and 84% of say-on-pay proposals, while directors received average support of 96% and say-on-pay proposals garnered average support of 93%. These examples demonstrate that investors don't blindly follow proxy advisor recommendations. In fact, according to ISS, 85% of its top 100 clients use a custom voting policy.

[If you use a proxy advisory service, describe how you interact with them, how you consider their reports as one piece of the overall voting decision, etc.]

Disclosure of conflicts of interest is appropriate for proxy advisory firms. However, this proposed rule goes too far and interferes with the investors' ability to obtain independent research that is not influenced by company management prior to publication.Thank you for your consideration of these comments.

Sincerely,

Name
Title

Additional Resources

SEC

Proposed Rule on Rule 14a-8 - https://www.sec.gov/rules/proposed/2019/34-87458.pdf

SEC Press Release and Fact Sheet - https://www.sec.gov/news/press-release/2019-232

Commissioner Rob Jackson Statement – https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting

Commissioner Jackson Voting Data Research - https://www.sec.gov/news/statements/2019/jackson-data-appendix-on-proposals-to-restrict-shareholder-voting.pdf

Commissioner Allison Lee Statement - https://www.sec.gov/news/public-statement/statement-lee-2019-11-05-shareholder-rights

Content

US SIF Website – www.ussif.org

Investors Rights Forum – www.investorrightsforum.com

Frequently Asked Questions - https://www.investorrightsforum.com/faq

Myths/Reality Fact Sheet (Shareholder Rights Group & ICCR) - https://www.sec.gov/comments/4-725/4725-6383229-197788.pdf

CII Fact Sheet on Proxy Advisory Firms and Shareholder Proposals - https://www.cii.org/files/about_us/press_releases/2019/11-05-19%20CII%20Fact%20Sheet%20on%20Proxy%20Advisory%20Firms%20and%20Shareholder%20Proposals.pdf