Building Meaningful Communication and Engagement with Shareholders

Mary Jo White, [excerpt, from remarks at the Society of Corporate Secretaries and Governance Professionals]
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Posted by Mary Jo White, U.S. Securities and Exchange Commission, on Thursday, June 25, 2015

Editor's note: Mary Jo White is Chair of the U.S. Securities and Exchange Commission. The following post is based on Chair White's remarks at the national conference of the Society of Corporate Secretaries and Governance Professionals, available here. The views expressed in this post are those of Chair White and do not necessarily reflect those of the Securities and Exchange Commission, the other Commissioners, or the Staff.

I am honored to be with you here in Chicago at the Society's 69th National Conference. Over the years, the Society has consistently provided thoughtful comments to the Division of Corporation Finance and the Commission on a wide variety of issues and proposed rules. You understand the complexities that can affect multiple parties and recognize the importance of the interests of shareholders. All of you play a critical role in corporate governance. It is the decisions you make, the practical solutions you advance and the views you share with your boards that can, in large part, dictate the relationship between shareholders and companies.

Because of your central roles in your companies, many of the Commission's initiatives are of interest to you: our disclosure effectiveness review; the audit committee disclosures concept release the staff is working on; and any number of our rulemakings. My hope is that you will see near-term activity in these and other areas, including rules mandated by the Dodd-Frank Act, such as the clawbacks rule as required by Section 954, the pay ratio rule under Section 953(b) and the joint rulemaking on incentive compensation as required by Section 956. So stay tuned for those developments.

But today my focus is on a selection of proxy-related issues, another area of particular interest to you. And my overall theme complements the theme of your conference, "Connect, Communicate, Collaborate." Be proactive in building meaningful communication and engagement with your shareholders.

One of the most important ways that shareholders have to express their views to company management is through the annual proxy process. We know of your deep involvement and interest in maintaining a fair and efficient proxy voting system, a priority we share at the SEC. So, this morning, I will offer some of my thoughts on four proxy-related subjects that are topics currently under discussion: the delivery of preliminary proxy voting results by intermediaries; the concept of a universal proxy ballot; so-called "unelected" directors; and shareholder proposals.

Each of these issues has frequently placed companies and shareholders at odds and each has been the subject of calls for Commission or staff action to clarify the scope of our rules, to step-in to mediate a dispute, and, in certain cases, to write new rules. And we and the staff of the Division of Corporation Finance are reviewing the concerns raised to determine what the Commission or the staff can and should do in response. But, I ask you, as I share with you my views on these topics, to also consider what you could and should be doing in each of these areas.

Preliminary Voting Results

I will start with preliminary proxy vote information. As you know, in advance of a company's annual meeting, companies seek voting authority from their shareholders who do not plan to attend the annual meeting. Under the current system, proxy materials are distributed to shareholders directly, in the case of registered shareholders, and indirectly through brokers and banks, in the case of "street name" shareholders who own shares through their brokerage and bank accounts. Today, over 80% of the outstanding equity securities for publicly listed U.S. companies are estimated to be in street name.

The vast majority of banks and brokers retain an agent to send out the request for voting authority. In addition to delivering proxies to the company reflecting the instructions received from the beneficial owners, the agent makes preliminary vote tallies available to the company before the meeting. This allows the company to determine whether it will meet its quorum requirement. In addition to providing information on the quorum, access to this information also allows the company to assess the "direction" a vote is taking and to adjust its proxy solicitation strategy. That information is obviously not just valuable to companies, but also to the other participants who are conducting solicitations.

In the past, Broadridge, which is the single largest agent collecting vote tallies, had established the practice of providing the voting tallies of street name shares to a shareholder proponent when the proponent had mailed exempted soliciting materials to shareholders and signed a confidentiality agreement. It did this so long as the banks and brokers did not raise an objection. But, in May 2013, certain brokers objected to the early release of voting data to shareholder proponents. Broadridge's response was that, as an agent, it is contractually bound to follow the directions of the brokers. As a result, it no longer provides the preliminary voting tallies to shareholder proponents who have distributed exempted solicitation materials and are willing to sign a confidentiality agreement, unless the company subject to the solicitation affirmatively consents. Investor groups and academics have expressed concern about this turn of events and argue that equal access to the information is required.

A variety of interested parties have asked the Commission to either interpret existing rules or adopt new rules to clarify that brokers are obligated to require their agents to deliver preliminary vote tallies to all interested participants. The SEC's Investor Advisory Committee, for example, has stated that the requirement that brokers and their agents act in an impartial fashion in distributing proxy materials should include the delivery of preliminary voting information. The Advisory Committee and others have criticized the selective disclosure of such information to companies and not shareholders and its potential effect on voting results.

The proxy rules are silent on preliminary vote tallies. The staff in the Division of Corporation Finance, after reviewing the various rules that govern proxy solicitations, has acknowledged that the current rules do not address directly whether a broker (or its agent) is required or permitted to share such preliminary vote tallies with other parties.

Our rules, of course, do not prohibit issuers from sharing this information. As I have said on other occasions, companies should seek to engage in a constructive dialogue with their shareholders and work to facilitate constructive solutions to issues they raise. In this context, since companies have direct access to the voting results, they should themselves consider leveling the field by agreeing or consenting to a mechanism that provides the interim vote tallies to shareholder proponents. We understand that it is customary in a contested, non-exempt solicitation for companies and shareholder opponents to share each other's voting information in advance of the meeting. So we know it can be done. I would ask you to consider whether providing this information to the shareholder in an exempt solicitation is really that different.

If the Commission were to advance a rulemaking in this area, it could take several forms. A rule could condition the broker's exemption from the proxy rules on an overall "impartiality" requirement to level the playing field, such that everyone gets preliminary vote tallies, or nobody gets them. Alternatively, a rule could permit brokers to provide issuers with the total votes that have been cast only in order to determine quorum, rather than a preliminary vote tally that would indicate how the shareholders have voted.

As with many issues, while rulemaking certainly can provide a remedy, I would like you to consider whether rulemaking is the only way to solve these concerns. I understand that a possible solution was being worked on by the Society, the Council of Institutional Investors and Broadridge, but those discussions broke down. That is unfortunate. A solution that you and the other interested parties develop together can achieve a good compromise and strengthen relationships. Indeed, companies should see this not as a problem to be solved, but as an opportunity to improve investor relations.

Universal Proxy Ballots

Universal proxy ballots: there has been renewed discussion about whether the proxy rules currently provide shareholders with a sufficient range of choice in exercising voting decisions in election contests if they are voting by proxy rather than in person at the company's annual meeting. There are calls, as there were a number of years ago, for the Commission to consider requiring universal proxy ballots.

As you know, in a contested director election, it is not generally possible for shareholders to pick freely from nominees on each side's proxy cards unless they attend and vote in person at the meeting. By operation of state law requirements, the proxy rules, and practical considerations, shareholders executing a proxy face an either/or proposition: they can vote for either the entire slate of candidates put forward by management or by a proponent—they cannot pick and choose the individuals that they believe are the best candidates from the two slates.

While a proponent putting forth a minority slate of candidates under our "short slate" rule may "round out" its slate with some company nominees, it is the proponent who chooses which company nominees shareholders using the proponent's proxy card must support. State law generally provides that a later-dated proxy revokes an earlier-dated one, which can make it impossible or at least impractical to vote for some nominees on each side's card. And while under current proxy rules, both sides' nominees can consent to appear on each other's proxy cards, that consent is given very rarely, if ever.

Given these obstacles, some have requested that the Commission revise the proxy rules to facilitate the use of a "universal proxy ballot," a single proxy card that would list both management's and a proponent's nominees in contested director elections, allowing shareholders to vote for a mix of nominees of their own choosing.

As you know, we held a roundtable in February on ways to improve the proxy voting process. One panel focused on the state of contested director elections and whether changes should be made to the federal proxy rules to facilitate the use of universal proxy ballots. It was, as always, a lively discussion.

Some strongly believed that it was past time to consider adopting the universal ballot. Others questioned whether effecting only this change to the current proxy voting system was appropriate when so many other issues have also been raised, and expressed concern about possible unintended consequences. Panelists thus differed on whether the adoption of a universal proxy ballot would increase or decrease shareholder activism or otherwise impact the outcome of election contests. Some believed that it would embolden activists to run more contests. Others posited that it could stimulate increased cooperation and settlements between issuers and activists, thereby decreasing contests. No one specifically called into question the fundamental concept that our proxy system should allow shareholders to do through the use of a proxy ballot what they can do in person at a shareholders' meeting. Given the diverse set of views represented at our roundtable, I took this as at least a bit of a breakthrough.

All of the participants agreed that if the Commission were to revise the proxy rules to implement a universal proxy ballot, the "devil would be in the details." Questions include when a universal ballot could be used, whether it would be optional or mandatory and under what circumstances, whether any eligibility requirements should be imposed on shareholders to use universal ballots, what the ballot would look like, and whether both sides must use identical universal ballots. While I agree that the "devil will be in the details," I have asked the staff to bring appropriate rulemaking recommendations before the Commission on universal proxy ballots.

But, like so many issues that seem to unnecessarily have shareholders and companies at odds, this is one where you do not have to wait for the Commission to act. Give meaningful consideration to using some form of a universal proxy ballot even though the proxy rules currently do not require it. If a company's or proponent's nominees gave their consent to appear on the other side's proxy card, then all shareholders would have the full range of voting options available to them. I realize that putting this into practice may have its challenges and that companies could choose different ways of making it work. But it could be beneficial for your shareholders. And we would welcome hearing about your experiences as we consider rulemaking in this area. Providing shareholders with the same voting rights that they would have if they were present at the meeting and eliminating procedural obstacles should be a shared goal of both companies and shareholders.

“Unelected” Directors

Let me turn to the issue of directors who do not receive a majority of shareholder votes but who continue to serve on the board, sometimes—and not fondly—dubbed as “unelected” directors. A recent study showed that 85% of these directors were still board members two years after an unfavorable vote.

Although such situations are rare, the seeming indifference of management when they do occur has understandably garnered significant interest. What does the continued presence of such directors say about a company’s general responsiveness to its shareholders?

In recent years, there has been a shift away from corporate practices that simply allow directors to remain when less than a majority of shareholders wants them there. “Plurality plus resignation” and majority voting regimes have become the norm at larger companies, and require at least some action by the director and board.

Under a plurality plus resignation voting regime, the director nominees agree in advance to resign if they receive a majority of withhold votes. The remaining directors then determine, in their discretion, whether to accept or reject the resignation. Under a majority voting regime, directors are elected only if they receive a majority of the votes cast. But as a result of the “holdover” rule under state law, an incumbent director who does not receive the requisite votes may remain in office until the earlier of the successor’s election and qualification or the incumbent director’s resignation or removal. In these instances, the board may determine not to accept the incumbent director’s resignation until a successor joins the board.

Some recent data suggests that shareholders’ expression of disapproval in uncontested elections do have an impact. A 2015 study, for example, shows that withheld votes are associated with increased director turnover. The same study showed that directors who face even a 30% dissent rate are more likely to depart from the board, and if they remain, they are more likely to be moved to less prominent positions on the board.

Views differ on whether individuals should be prohibited from continuing to serve on boards when they do not receive a majority of shareholder votes. Ultimately, whether an individual can remain on the board following an election where they do not receive majority support is a question of state law and the governance decisions made by boards. Some, however, have recommended that the Commission require companies to disclose the specific reasons why the board chose to retain a director who did not receive a majority vote regardless of the type of voting regime in place. Others favor an approach where the NYSE and NASDAQ would impose new listing standards requiring listed companies to adopt a majority voting regime that imposes reasonable limits on the ability of boards to reject the resignation of such directors.

If a director receives a majority withhold vote and remains on the board, the company should consider that its shareholders may want to know about that director’s service on the board and the decision to let the board member remain. It is hard, indeed, to imagine that a company would not want to provide its shareholders with a specific explanation of the board’s thinking on retaining the board member.

We could certainly amend our proxy rules to, among other things, mandate more specific disclosures on these board decisions. But, any company that is serious about good corporate governance should provide such information on its own. It should share the board's thought process and reasons with shareholders—inform the shareholders in clear terms why the board member's resignation was not accepted, why the director was considered important for the strength of board decision-making, for the growth of the company, for the relevant experience represented, or for the expertise that would be lost. Be specific, and avoid boilerplate. Shareholders are interested and likely quite willing to listen to reasonable explanations. To be sure, they could evaluate the additional information and express disagreement with the decision not to remove the board member, which would provide further information for you to consider about your shareholders' views on removal.

Shareholder Proposals

My final topic is another area of shareholder engagement that is near and dear to all of you—shareholder proposals. As you know, it has been a busy and interesting season. The staff received more than 300 requests from over 200 companies to exclude shareholder proposals addressing a wide range of topics from human rights to proxy access. Overall, the number of requests was up approximately 10% from the prior season, but down slightly from two years ago.

This season, the matter that received the most attention was Rule 14a-8(i)(9), particularly as it related to proxy access proposals.

Rule 14a-8(i)(9), as you know, allows a company to exclude a shareholder proposal that "directly conflicts" with one of the company's own proposals. After an initial no-action letter was issued by the staff, questions, from me and others, were raised about the proper scope and application of the rule. After I directed the staff to review the application of the rule, the Division of Corporation Finance decided to express no view on the application of Rule 14a-8(i)(9) during this proxy season. These decisions were not made lightly as we fully recognize the need for clarity and certainty in the proxy process during every season. But it is important to get these issues right.

The suspension of staff views on the application of Rule 14a-8(i)(9) this season did give a window into some private ordering at work. More than 100 companies received proposals to adopt some form of proxy access. Proxy access proposals received majority support at more than 40 companies, as compared to four last year. At seven companies, the company's proxy access proposal was included alongside a proxy access proposal offered by a shareholder. Shareholders preferred management's proposals at three companies, and at three others, they preferred the shareholder's proposal. At one company, the shareholders did not approve either proposal and there were no instances where shareholders approved both proposals. While all of these results are informative, this last one may be of particular interest to you.

The Society and others were very concerned that shareholders would be confused by two "competing" proposals and that companies would not know what to do if shareholders voted in favor of both proposals. Based on this year's experience, that did not occur. It seems that shareholders were able to sort it all out and express their views. The staff is considering that fact and the other results of the season as it completes its review of Rule 14a-8(i)(9)—obviously with the goal of providing clarity for next year's proxy season.

Like the controversy about Rule 14a-8(i)(9), the issues that generally get the most attention each proxy season are those that are the subject of requests for no-action letters. But I would like to focus some attention on the shareholder proposals our staff never sees.

Each proxy season, SEC staff gets involved in roughly 300 to 350 proposals that companies seek to exclude. The staff generally does not track the proposals that companies do not seek to exclude, but we estimate that another 300 to 400 proposals are included in management's proxy statement without any staff involvement. Even with respect to the no-action requests, companies consistently withdraw 15 to 20% of them before the staff ever provides its views. We do not always know precisely what happens, but it is our understanding that management and the shareholders generally have arrived at some resolution on their own. That is good and evidence that the company/shareholder relationship is working.

I am not suggesting that management should never object to or oppose a shareholder proposal. Company management in good faith can believe that particular proposals are not in the best interests of their shareholders and there are also costs involved in processing shareholder proposals. But companies in many cases should consider other possible steps they could take in response to a proposal rather than just saying no. Sometimes, foregoing technical objections could be the right response. Letting shareholders state their views on matters may be a relatively low cost way of sounding out and preventing potential problems down the line.

More thoughtful treatment of shareholder proposals is not a one-way exercise. Briefing boards, analyzing issues and determining how to communicate the company's views to shareholders and markets take time and resources, as does hiring lawyers to analyze the proper interpretation of the Commission's grounds for exclusion and preparing communications with the staff. And I would urge shareholder proponents to be mindful of the costs they can cause to be borne by their companies—and thus, by their fellow shareholders—and to use the shareholder proposal process responsibly. Seek engagement with the company on an issue first before turning to a shareholder proposal. Direct engagement with a company is likely to be more meaningful than a precatory vote on a 500-word proposal. Some companies are better at engagement than others, but I would urge more companies to embrace it so that more shareholders will be incentivized to choose direct engagement as their preferred first approach.

Conclusion

The four areas I talked about today obviously represent only a small part of the broader company-shareholder relationship and a small sample of proxy-related issues we are considering at the Commission. We are very interested in what you think and how you are approaching the full range of issues and practices that relate to enhanced shareholder engagement and more meaningful communications. Your leadership can help to constructively address the issues and to develop and share best practices. I wish you success at that and a very productive conference. Thank you for all you do.