

*From the Public Company Advisory Group of Weil, Gotshal & Manges LLP*

November 20, 2018

## **Key Takeaways from the SEC’s Proxy Process Roundtable: Is Proxy Voting Reform on the Horizon?**

*By Adé Heyliger and  
Aabha Sharma*

On November 15, 2018, the SEC held an all-day roundtable to hear the views of investors, issuers, proxy advisors and other market participants on the proxy process and rules amidst growing public debate on the efficiency of the proxy voting process, including the accuracy and transparency of the process, and the role played by proxy advisory firms in the current proxy voting landscape. In this alert, we provide our key takeaways from the roundtable’s three panels, as well as a few early takeaways from certain members of the SEC’s Division of Corporation Finance (the “Staff”) delivered either at the conclusion of each panel or in meetings held the following day as part of the ABA’s Business Law Section Fall Meeting.

As discussed in our previous Alert [available here](#), with a traditionally hands-off approach to regulation in the area of “proxy plumbing,” there has been little in the way of proxy regulatory reform during the last decade. During opening remarks, the SEC Chair and other Commissioners recognized the need to review the current proxy process in order to protect long-term beneficial owners.<sup>1</sup> Specifically, Chair Clayton noted that improving the capital market system is for “our long-term Main Street investors . . . those who have put or are putting \$50, \$100, \$200 a month away for years and years.” They also acknowledged the challenges and inefficiencies inherent in the current process, including diminished accuracy and transparency in the voting process, as well as the inability of issuers to communicate directly with street-name shareholders under existing proxy rules.

The roundtable was a highly anticipated event, with approximately one hundred [comment letters](#) submitted since its September 21, 2018 [announcement](#).<sup>2</sup>

### **Proxy Voting Mechanics and Technology: Panel 1**

While discussing the mechanics of proxy voting, several of the panelists raised the following concerns:

- Inaccuracies in the proxy voting process, including the potential for over-voting and under-voting of securities by broker-dealer and bank custodians, due at least in part to multiple layers of intermediation and chain of custody issues;
- Failure to receive voting confirmations verifying that an investor’s shares have been voted in accordance with the investor’s instructions; and
- The decreasing level of retail shareholder participation in the proxy voting process.

While there did not seem to be a consensus amongst panelists regarding a path forward, there was broad agreement regarding the need for fixing identifiable proxy plumbing problems. Some recommendations for the SEC offered by panelists, while not universally agreed upon, included:

- Undertaking pilot programs and/or providing guidance to improve the reliability of the vote confirmation process, through among other things, encouraging greater cooperation of intermediaries whom some panelists argued may not currently be incentivized to improve efficiency and implement protocols for proxy vote reconciliation (e.g., by moving away from a fungibility to a traceability approach);
- Examining the reasons for declining retail shareholder participation, including the distinction made by the SEC's proxy rules between "objecting beneficial shareholders" (OBO) and "non-objecting beneficial shareholders" (NOBO), and the use of certain technology to improve participation; and
- Exploring the use of existing technology, such as blockchain voting, to improve the quality of proxy voting and engagement with all shareholders (including but not limited to street-name holders, whether OBOs or NOBOs), while still protecting investor privacy.

In addition to suggestions to improve the current proxy plumbing problems, many panelists recommended implementing the 2016 proposal for universal proxy voting cards in a thoughtful manner. Support for the concept of universal proxies seems to have grown over the intervening years, and this new momentum was recognized by the Staff.

The Staff also took notice of the fact that there was near unanimous agreement among the panelists that no one is happy with the status quo and that reform is needed, though there is certainly disagreement among the various proxy participants with respect to what form those changes should take.

Division of Corporation Finance Director William Hinman observed, during the ABA's Dialogue with the Director the following day, that suggestions regarding the use of a gatekeeper-administered blockchain (distributed ledger) technology showed promise. He commented that this and other forms of communications technology had become available well after the SEC published its [Proxy Plumbing Concept Release](#) in 2010. Mr. Hinman further indicated that the Division has received some very thoughtful comment letters offering a variety of constructive ideas for potential solutions, and encouraged the securities bar to provide more input.

### **Shareholder Proposals – Exploring Effective Shareholder Engagement: Panel 2**

While there seemed to be agreement on the importance of year-round corporate-shareholder engagement, panelists had varying opinions on the most effective channels for engagement. Several panelists emphasized the importance of using shareholder proposals as a vehicle not only for shareholders to communicate with companies, but also for shareholders to communicate with each other. Shareholder representatives on the panel expressed the view that the current shareholder proposal system "works." Others, however, disagreed – highlighting the cost of such proposals to issuers.

#### ***Rule 14a-8: Eligibility Requirements***

Some panelists expressed concerns of the corporate community regarding the need to update current Rule 14a-8 proponent eligibility requirements, noting in particular that there should be a "meaningful" ownership standard (both amount and length of stock ownership). Some suggestions addressing the current thresholds for minimum ownership included:

- Increasing the minimum stock holding period requirement for shareholders of companies that recently became public; and
- Increasing the ownership thresholds for proposals by proxy and proposals co-filed by multiple filers to prevent abuse of the shareholder proposal process.

Certain panelists also encouraged the SEC to consider disclosure rules which would identify Rule 14a-8 proponents in proxy materials.

The effect of “zombie proposals”, or proposals that have been resubmitted, but fail to garner significant shareholder support, was also debated, with differing views on the burden of such proposals on companies. Several of the panelists urged the SEC to reexamine the shareholder proposal re-submission thresholds (minimum vote requirements as pre-requisite for resubmission to a vote at successive annual meetings for election of directors), noting the importance of striking an appropriate balance between the cost to companies arising from such multi-year inclusions of proposals that attracted de minimis shareholder support in prior years, and the benefits of facilitating shareholder communication (a key purpose of Rule 14a-8). However, certain Staff members left the roundtable with the impression that stronger arguments were made in favor of keeping the current Rule 14a-8 eligibility requirements and resubmission thresholds.

### ***Rule 14a-8: Excludability of Shareholder Proposals***

The topic of shareholder proposals under Rule 14a-8 was not only at the forefront during roundtable discussions, but has also been on the SEC’s radar recently. Last month, the SEC published [Staff Legal Bulletin \(SLB\) No. 14J](#), which addresses the Division of Corporation Finance’s expectation that no-action requests that seek to rely on Rules 14a-8(i)(5), the “economic relevance” exception, or 14a-8(i)(7), the “ordinary business” exception, as a basis to exclude shareholder proposals include a description of the board of directors’ analysis of the particular issue raised and its significance to the company. The Division, in SLB No. 14J, notes that while the inclusion or absence of a board analysis will not be dispositive in its evaluation of a company’s request, it may be difficult in certain instances to agree to a proposal’s exclusion without having the benefit of the board’s views. With the SEC’s recent efforts to provide continuing guidance on issues arising under Rule 14a-8, the Staff noted during the roundtable that it was seeking director input as to what other factors the board may consider, other than those noted in SLB No. 14J, when determining to exclude a shareholder proposal on “economic relevance” and/or “ordinary business” grounds. In response, a panelist requested that the Staff include additional information about the basis of its determination in its Rule 14a-8 no-action decisions. Additional clarity was also requested regarding the “weight” given by the Staff to previous shareholder voting results.

### **Proxy Advisory Firms – The Current and Future Landscape: Panel 3**

The most anticipated panel of the day focused on the role of proxy advisory firms, including the extent to which proxy advisors influence shareholder voting decisions, the accuracy of such firms’ research forming the basis for voting recommendations, and the disclosure of any conflicts of interests. While Commissioner Stein questioned in her opening remarks whether proxy advisors should be regulated, she noted that a bipartisan bill entitled the [Corporate Governance Fairness Act](#) was introduced in the Senate just the day before the roundtable. The bill would subject certain proxy advisory firms to the Investment Advisers Act of 1940 and put them under the regulatory jurisdiction of the SEC.

To kick-off the session, institutional investor panelists first discussed the role of proxy advisory firms, noting that they rely on proxy advisors to provide platforms for managing votes, data aggregation and research insights. However, they emphasized that rather than engaging in “robo-voting,” they instead rely on their own proxy voting guidelines which ultimately determine their voting decisions.

With respect to specific recommendations, some panelists recommended that proxy advisors provide issuers with the opportunity to correct factual inaccuracies in their reports prior to publication, and for proxy advisors to create a standardized process by which they would provide all issuers, regardless of size, the same rights to review their reports prior to publication.

Panelists also discussed whether there is sufficient transparency regarding proxy advisor conflicts of interests, including those arising from offering consulting services to companies that are subject to proxy voting reports and recommendations to institutional investors provided by such proxy advisors. Several of the panelists noted that

conflicts are clearly disclosed by proxy advisors, expressing little concern about a lack of transparency. Proxy advisory firm, Institutional Shareholder Services Inc., additionally noted the implementation of a firewall between its consulting and research services to manage potential conflicts.

Interestingly, when asked by an SEC Staff member whether proxy advisors should be subjected to enhanced regulation, there was far from overwhelming support for the idea – though a panelist expressed concern about the barriers to entry in the proxy advisory field. Moreover, some panelists worried that increased regulation may result in added costs to investment advisers. Further, certain Staff members left the roundtable with the impression that, although issuers still have fair concerns about having a proper opportunity for review, clients of proxy advisory firms for the most part seem to be satisfied with the service they are receiving as well as the conflicts disclosure.



## ENDNOTES

<sup>1</sup> Chair Jay Clayton's roundtable statement is available [here](#); Commissioner Kara Stein's roundtable opening remarks is available [here](#); Commissioner Elad Roisman's roundtable statement is available [here](#).

<sup>2</sup> During the event, the Commissioners, all of whom were present at various points, and Staff from the Divisions of Corporation Finance and Investment Management encouraged the submission of additional comment letters to supplement the panelists' discussions, emphasizing the importance of including specific facts and data supporting specific recommendations to improve the quality of proxy voting.

\* \* \*

Please contact any member of Weil's Public Company Advisory Group or your regular contact at Weil, Gotshal & Manges LLP:

Howard B. Dicker	<a href="#">View Bio</a>	<a href="mailto:howard.dicker@weil.com">howard.dicker@weil.com</a>	+1 212 310 8858
Catherine T. Dixon	<a href="#">View Bio</a>	<a href="mailto:cathy.dixon@weil.com">cathy.dixon@weil.com</a>	+1 202 682 7147
Lyuba Goltser	<a href="#">View Bio</a>	<a href="mailto:lyuba.goltser@weil.com">lyuba.goltser@weil.com</a>	+1 212 310 8048
Adé K. Heyliger	<a href="#">View Bio</a>	<a href="mailto:ade.heylinger@weil.com">ade.heylinger@weil.com</a>	+1 202 682 7095
P.J. Himelfarb	<a href="#">View Bio</a>	<a href="mailto:pj.himelfarb@weil.com">pj.himelfarb@weil.com</a>	+1 202 682 7208
Ellen J. Odoner	<a href="#">View Bio</a>	<a href="mailto:ellen.odoner@weil.com">ellen.odoner@weil.com</a>	+1 212 310 8438
Alicia Alterbaum	<a href="#">View Bio</a>	<a href="mailto:alicia.alterbaum@weil.com">alicia.alterbaum@weil.com</a>	+1 212 310 8207
Kaitlin Descovich	<a href="#">View Bio</a>	<a href="mailto:kaitlin.descovich@weil.com">kaitlin.descovich@weil.com</a>	+1 212 310 8103
Andrew Holt*	<a href="#">View Bio</a>	<a href="mailto:andrew.holt@weil.com">andrew.holt@weil.com</a>	+1 212 310 8807
Erika Kaneko	<a href="#">View Bio</a>	<a href="mailto:erika.kaneko@weil.com">erika.kaneko@weil.com</a>	+1 212 310 8434
Niral Shah	<a href="#">View Bio</a>	<a href="mailto:niral.shah@weil.com">niral.shah@weil.com</a>	+1 212 310 8316
Aabha Sharma	<a href="#">View Bio</a>	<a href="mailto:aabha.sharma@weil.com">aabha.sharma@weil.com</a>	+1 212 310 8569

© 2018 Weil, Gotshal & Manges LLP. All rights reserved. Quotation with attribution is permitted. This publication provides general information and should not be used or taken as legal advice for specific situations that depend on the evaluation of precise factual circumstances. The views expressed in these articles reflect those of the authors and not necessarily the views of Weil, Gotshal & Manges LLP. If you would like to add a colleague to our mailing list, please [click here](#). If you need to change or remove your name from our mailing list, send an email to [weil.alerts@weil.com](mailto:weil.alerts@weil.com).

\*Not yet admitted in New York