November 6, 2018

Hon. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File 4- 725 -- Staff Roundtable on the Proxy Process

Dear Chairman Clayton,

In response to your July 30th statement announcing a Staff Roundtable on the Proxy Process, the Interfaith Center on Corporate Responsibility (ICCR), a coalition of more than 300 institutional investors collectively representing over $400 billion in invested capital, wishes to express our affirmation of the current shareholder proposal process as effective, efficient and beneficial to both shareholders and the long-term well-being of the companies they hold. Our members are composed of a cross section of religious investors, foundations, asset managers, pension funds, and other long-term institutional investors. Members of ICCR have been involved in the shareholder resolution process since 1971, giving us over 45 years of experience in shareowner engagement and the proxy process.

We submit this brief comment in advance of the Staff Roundtable, and will be providing a more in-depth comment subsequent to the Roundtable.

We firmly believe that there is no need to revise the rules governing the proxy process. For decades, the shareholder proposal process has served as a cost effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own. This efficient system of private ordering has led to the widespread adoption of a number of constructive corporate governance practices that have become standard in the field, such as independent directors, declassifying boards, “say on pay” vote requirements, and many others. The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of productive engagement with shareowners.

The Roundtable announcement lists several potential topics for consideration regarding the shareholder proposal process, among them ownership thresholds, resubmission thresholds, representation of long-term retail investors, the cost of proposals to companies, and the influence of proxy advisory firms.

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard including smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

The issue of resubmission thresholds is also raised as a topic for discussion. We believe the current thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even receive a shareholder resolution. It is also worth noting that often resolutions are withdrawn by their proponent after prompting a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes that can transform businesses. ICCR member experience has shown that approximately one third of resolutions filed result in dialogue and agreements, with resolutions being withdrawn from the proxy.

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks they presented to companies. The issue of declassified boards is just one example – support of shareholder proposals on this issue was regularly below 10% in 1987, but eventually grew to 81% in 2012, and it is now considered best practice.

There are numerous additional examples, including:

Resolutions with oil and gas majors beginning in 1998 requested reporting on the risks of climate change. In the early years, these resolutions often received below 5% of shareholder support. The 2017 proxy season saw a resolution requesting a business plan in alignment with the 2° C warming threshold established in the Paris Climate Agreement achieve a 67% vote at

Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources.

Resolutions highlighting human rights risks in corporate operations and global supply chains have brought human trafficking and forced labor to the forefront. As a result of proxy pressure, sector leaders such as Coca Cola, HP, Ford and Gap now have human rights policies and supplier codes of conduct that help them uncover and eradicate these violations from their supply chains - along with the legal, reputational and financial risks they represent.

Proposals like these and many others could be excluded in increasing re-submission thresholds, potentially inhibiting important contributions to corporate governance that have proven to be beneficial to the long term health and performance of companies.

The influence of proxy advisory firms was also raised as a potential topic for review. Critics have posited misperceptions about these firms, including that they have excessive influence. While institutional investors do look to proxy advisory firms to provide research and guidance to help inform their decisions, the ultimate decision remains in the hands of the investor. There is no obligation to follow the recommendations of the proxy advisors, and there are plenty of examples in which investors vote counter to their recommendations. The real motivation behind the special interests opposed to the proxy advisory firms is to undermine the in-depth analysis that they provide and encourage investors to simply vote in alignment with how corporate boards and management see fit, regardless of fiduciary duty or interest in long-term shareholder value.

Critics of the shareholder resolution process, including major trade organizations like the Business Roundtable, the National Association of Manufacturers, and the U.S. Chamber of Commerce, use over-the-top rhetoric to try and discredit resolution sponsors, arguing that their motives are “political” and that they have no interest in creating shareholder value. These industry critics have a clear political agenda of their own – to limit the ability of shareholders to engage with the companies that they own, and to cripple the proxy process that has been in place for over fifty years. The long-term investors who are members of ICCR are deeply concerned about the returns on and growth of the investments in their portfolios. Our members press companies on environmental, social, and governance risks precisely <u>because</u> they are concerned with the long-term health of the companies in which they are invested. Many of the companies that we engage see the great value that this engagement brings, for example, by enabling them to identify and address reputational and legal risks in advance, before they become liabilities.

For further consideration, attached is a white paper drafted by Ceres, along with ICCR and The Forum for Sustainable and Responsible Investment (US SIF) entitled, “The Business Case for the Current SEC Shareholder Proposal Process.” This paper provides an investor perspective on the value to both companies and investors of the shareholder proposal process as currently outlined under SEC Rule 14a-8.

In conclusion, we reiterate ICCR's support of the shareholder proposal process as it is currently practiced under Rule 14a-8 and believe altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected.

We appreciate this opportunity to provide input and look forward to providing additional written feedback following the Roundtable. Please feel free to contact me with any questions.

Sincerely,

Josh Zinner
CEO
Interfaith Center on Corporate Responsibility
[redacted]

The Business Case for the Current SEC Shareholder Proposal Process

April 2017

About Ceres

Ceres is a sustainability nonprofit organization working with the most influential investors and companies to build leadership and drive solutions throughout the economy. Through our powerful networks and advocacy, we tackle the world's biggest sustainability challenges, including climate change, water scarcity and pollution, and human rights abuses.

The **Ceres Investor Network on Climate Risk and Sustainability** comprises more than 130 institutional investors, collectively managing more than $17 trillion in assets, advancing leading investment practices, corporate engagement strategies and policy solutions to build an equitable, sustainable global economy and planet. For more information, visit www.ceres.org.

About ICCR

The Interfaith Center on Corporate Responsibility (ICCR) is a 46 year-old, pioneer coalition of over 300 organizational investors representing faith-based communities, socially responsible asset managers, labor unions, and others who engage corporations on the environmental and social impacts of their operations.

About US SIF

US SIF: The Forum for Sustainable and Responsible Investment is the leading voice advancing sustainable, responsible and impact investing across all asset classes. Our mission is to rapidly shift investment practices towards sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Our 300+ members collectively represent more than $3 trillion in assets under management or advisement.

Acknowledgements

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Contact

For more information, contact:
Rob Berridge
Director, Shareholder Engagement, Ceres
berridge@ceres.org

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About this paper

This paper provides an investor perspective on the value to investors and companies of the current shareholder proposal process under SEC Rule 14a-8. It was prepared by Ceres investor program staff with major contributions from numerous investor members of the Ceres, ICCR and US SIF investor networks, who have been active in filing shareholder proposals as part of their corporate engagement and asset stewardship efforts. It is intended as a resource to help inform policy discussions about the content of Rule 14a-8 and the impact of shareholder proposals on corporate issuers, shareholder value and the U.S. economy.

Introduction

In 1942, the U.S. Securities and Exchange Commission (SEC) promulgated its first rule regulating shareholder proposals, and the rule has been adjusted and fine-tuned repeatedly since then.[1] For more than seven decades, the shareholder proposal process has allowed both large and small shareholders to alert corporate boards and the investor community to their concerns and to request timely action on emerging, or neglected, issues. A key element of process allows shareholders who meet certain criteria to submit proposals for inclusion in the company's proxy statement for a vote by all shareholders holding voting shares.

In 2016, shareholders filed approximately 1,000 shareholder proposals with U.S. companies.[2] This includes more than 400 proposals focused on environmental and social issues, and more than 500 focused on pure corporate governance. Voting on these shareholder proposals is an important part of the exercise of institutional investors' fiduciary duty on behalf of their clients and beneficiaries. This paper describes the benefits of the current shareholder proposal process to investors, companies, and society.

The principal benefits of the current shareholder proposal process include the following, as discussed in more detail below:

- It is an essential and cost-effective tool for investors, individually and collectively, to protect and enhance the value of their investments by expressing their views to management, boards and other shareholders on major governance issues, corporate policies, and important risks and opportunities.
- It is a uniquely forward-looking, flexible, and efficient way to raise and resolve issues.
- It can benefit company managers and directors by making them aware of emerging issues that can materially affect the company's performance, without imposing significant costs.
- It helps investors to protect their ownership rights and interests and helps to hold corporate boards accountable to the owners of the corporation.
- It has led to the widespread adoption of numerous beneficial corporate governance and sustainability policies by companies.

[1] http://scholar.valpo.edu/cgi/viewcontent.cgi?article=1500&context=vulr, p. 227
[2] ISS Voting Analytics database.

- It has enabled investors to raise unaddressed systemic risks to the economy caused by companies who also face company-specific risks on the issues.
- The shareholder proposals it facilitates have been shown to improve company financial performance and value.
- It provides access to management and boards by individual and institutional investors who otherwise would not have a voice, and enables owners to aggregate their voices via proxy voting on proposals.

In short, the process as currently structured and administered works well for investors and issuers; it is fair, efficient and effective.

Business groups including The Business Roundtable[3] (BRT) and the U.S. Chamber of Commerce[4] have proposed modifications to the existing shareholder proposal process that would significantly limit shareholders' ability to use this tool to raise issues with corporate boards, who are charged with representing their interests. We believe the proposed modifications would harm the interests of investors, companies, society and the capital markets.

Background

In 1934, Congress passed the Securities Exchange Act. Section 14 of the Act authorized the SEC, as part of its mission "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," to develop proxy regulations "in the public interest" and "for the protection of investors." Over time, the SEC developed a body of regulations that came to be collected in Rule 14a-8, including the thresholds and limitations governing whether and how shareholder proposals are listed in the company's proxy statement.[5]

Under state laws, shareholders have a right to vote by proxy as an alternative to attending a corporate annual meeting in person to cast their vote. Shareholders also have the right to raise issues from the floor of corporate annual meetings. The SEC Proxy Rules, including Rule 14a-8, support these state law rights by ensuring that widely dispersed investors have the opportunity to raise issues and vote their shares as if they were in attendance. The company is required by the SEC to distribute a proxy statement to all shareholders prior to the meeting, which allows them to vote in absentia.

The great majority of shareholder proposals are nonbinding or advisory. Nonbinding proposals give companies the flexibility to address shareholder concerns without displacing the traditional role of the board of directors to oversee the operations of the company. Boards are free to ignore

[3] https://www.bna.com/business-roundtable-suggests-b57982082135/
[4] https://www.bna.com/us-chamber-calls-n57982063976/
[5] Matsusaka, John G. and Ozbas, Oguzhan and Yi, Irene, Why Do Managers Fight Shareholder Proposals? Evidence from No-Action Letter Decisions (January 9, 2017). USC CLASS Research Paper No. CLASS17-4. Available at SSRN: https://ssrn.com/abstract=2881408 or http://dx.doi.org/10.2139/ssrn.2881408

nonbinding shareholder proposals, although high votes (e.g., above 25-30%) send a strong signal that many investors want the issue addressed.

Majority votes very frequently spur companies to act in part because shareholders – in a sign of respect for the importance of the Rule 14a-8 process – are more likely to withhold their support from directors that ignore shareholder proposals that receive majority levels of shareholder support. This flexibility is an inherent strength of the existing shareholder proposal process, which serves as an important warning mechanism for boards.

The resolution process now operates within the context of the rapid growth of environmental, social and governance (ESG)-related investment practices and increasing materiality to investors of a range of ESG issues. More than 20 percent of assets under professional management in the United States are now associated with various forms of ESG investing according to US SIF Foundation's 2016 *Report on US Sustainable, Responsible and Impact Investing Trends,* a 33 percent increase since 2014.[6] The more than 1,600 signatories to the Principles for Responsible Investment, collectively managing over $60 trillion, are publicly committed to six principles including "active ownership" and to "seek appropriate disclosure on ESG issues by the entities in which we invest."[7] Large investment firms, including Bank of America / Merrill Lynch, Blackrock, Credit Suisse, Goldman Sachs, Morgan Stanley, State Street Global Advisors, UBS, and others provide numerous research and investment products focusing on ESG topics. Many investors view ESG performance as a valuable proxy for the quality of corporate management and a key indicator of long-term financial performance.

Support for shareholder proposals comes from a broad base of investors. The vast majority of proposals are filed by institutional owners with large and long-term holdings or individuals with similarly long-term interests, with the balance coming from smaller institutional investors. Shareholder support for proposals has climbed steadily and represents a significant proportion of investors. In 2016, 61 percent of proposals that came to a vote received at least 25 percent support from shareholders, up from 31 percent with that level of support in 2000.[8] The proportion of proposals that win the support of a majority of shareholders has risen too. In 2016, 21 percent of proposals received a majority of votes cast, up from 15 percent in 2000.

Examples of shareholder proposals that were widely adopted

For over half a century, the shareholder proposal process has served as an effective way for investors to provide corporate management and boards with insights into their priorities and concerns regarding corporate governance, policies and practices. The process has resulted in numerous important changes to corporate governance in the U.S. Examples include:

[6] http://www.ussif.org/files/Trends/US%20SIF%202016%20Trends%20Overview.pdf
[7] https://www.unpri.org/about
[8] ISS Voting Analytics

- Resolutions were the impetus behind the now standard practice – currently mandated by major US stock exchanges' listing standards – that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance.
- In 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two-thirds of these companies today.[9]
- Electing directors in uncontested elections by majority (rather than plurality) vote was considered a radical idea a decade ago when shareholders pressed for it in proposals they filed with numerous companies. Today, 90 percent of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority-voting proposals
- A proposal that built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years is the request for proxy access. Resolutions filed by the New York City Comptroller to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, at least 400 companies have adopted proxy access bylaws.
- "Say-on-pay" vote requirements – now mandated by the Dodd-Frank Act – also resulted from shareholder proposals.
- Shareholder proposals or related engagements played a key role in moving close to 160 large companies (including more than half of S&P 100 companies) to commit to disclosure and board oversight of their political spending with corporate funds.[10]
- Since 2009, 85 companies have agreed to issue sustainability reports as result of shareholder resolutions. According to the G&A Institute, 81 percent of S&P 500 companies published sustainability reports in 2015 compared to just under 20 percent in 2011.[11]
- The first resolution requesting that companies source deforestation-free palm oil went to vote in 2011. By 2016 more than 20 companies had responded to similar resolutions and protected their brands' reputations by committing to source deforestation-free palm oil produced by workers free from human rights abuses.[12]
- Shareholder proposals have led to wide-scale adoption of international human rights principles as part of corporate codes of conduct and supply chain policies, protecting companies from legal and reputational risk.
- 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

[9] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013
[10] http://politicalaccountability.net/impact
[11] http://www.ga-institute.com/press-releases/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html
[12] Data compiled by Ceres.

found that 270 companies which provided inclusive LGBTQ work environments outperformed global stock markets by 3 percent annually for the previous six years.

Benefits to investors

The shareholder proposal process helps to protect investor interests

Common stockholders generally have six types of basic rights: the right to file and vote on shareholder proposals and to vote to elect directors (however not all share classes have voting rights); ownership in a portion of the company and a claim on a portion of the assets; transfer of ownership; entitlement to a portion of dividends set by the board of directors; the opportunity to inspect corporate books and records; and the right to sue for wrongful acts, including class action suits. (Corporate bylaws influence these rights, but they are generally applicable as listed.)

These rights are necessary but at times insufficient to protect investor interests. Chief among investor interests is maximizing risk-adjusted, long-term, portfolio-wide returns. And institutional investors generally have a fiduciary duty to act in the interest of their clients and beneficiaries.

As investors seek to protect their interests in accordance with their rights and obligations, they are confronted with a challenge. The tools they have to influence corporate behavior are more easily asserted after things have gone wrong with the company they own, when the issue is widely obvious, and the value of their investment has been impaired.

The shareholder resolution process is important because it allows investors to communicate with boards, management and other shareholders about ways to protect their interests in a proactive, forward-looking way on important corporate governance, risk and policy issues affecting companies, before a crisis arises that erodes shareholder value.

It promotes good corporate governance

The substantial history of corporate scandals clearly demonstrates that the separation of corporate ownership and control allows managers substantial leeway to pursue their own interests, which can at times be at the cost of shareholder wealth.[13] The shareholder resolution process acts as a critical safeguard against these agency problems, and enables all shareholders holding voting stock, including relatively small ones, to encourage management and boards to address ESG issues that they believe are significant to the company and to society.

Examples of managerial strategies that could be classified as "ESG failures" and were disastrous for investors and employees abound: AIG, Bear Stearns, Lehman Brothers, BP, Enron, WorldCom, Fannie Mae and Freddie Mac, Massey Energy, Volkswagen and Wells Fargo. Scandals and disasters are the visible portion of the larger iceberg of incentives that lure corporate managers to manage for the short term and take excessive risk at shareholders' expense.

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[13] The Modern Corporation and Private Property. By Adolf A. Berle, Jr. and Gardiner C. Means. New York: The Macmillan Company, 1932.

The world's largest asset managers are acting to address these risks. A letter sent in January 2017 from State Street Global Advisors' CEO Ron O'Hanley to board members of companies in which State Street owns shares says that ESG issues "can have a material impact on a company's ability to generate returns," and that "as stewards we are convinced that addressing ESG issues is a good business practice and must be part of effective board leadership and oversight of long-term strategy."[14] In addition, The Investor Stewardship Group, a coalition of sixteen of the largest institutional investors managing $17 trillion collectively, premiered in January 2017 the Framework for U.S. Stewardship and Governance, outlining a set of six fundamental governance principles for U.S. listed companies.[15]

However, few investors have the clout and access to boards enjoyed by the very largest institutional investors, and shareholder proposals and proxy voting are critical tools to urge companies to adopt the best corporate governance practices and to address material ESG issues.

The proposal process helps enhance board accountability

Boards of directors are charged with ensuring that company management acts in the best interests of the company and its shareholders. In reality, they sometimes fail in this regard for a number of reasons including: use of insufficient or incorrect information; "group think" and lack of diversity; an overly deferential approach to the managers they oversee; or by acting in their own interests. Shareholder proposals can strongly encourage boards and management to address ESG issues that they might otherwise overlook or ignore.

Investors have several tools to communicate with corporate boards tasked with representing shareholder interests. Proxy voting is one. However, without the ability to put items on the proxy, most investors would lack sufficient influence and access to convey their concerns and requests to the board.

Voting against (or withholding votes from) directors is one option for shareholders, but this is a blunt instrument, providing the director no information as to the rationale for the vote, or the underlying issue. And voting against directors due to a specific environmental or social problem is likely to gain momentum only after an adverse event occurs, by which time investors will already have seen the damage to returns. On the other hand, shareholder proposals allow investors to signal their expectations and/or displeasure on individual ESG issues without resorting to withholding their vote from directors.

Successful boards must be knowledgeable about and responsive to a wide range of issues affecting the company. Provided with enough information and a strong enough signal from shareholders, directors and management can often successfully address ESG issues. One of the

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[14] In March of 2017, State Street managed approximately $2.4 trillion. https://www.ssga.com/investment-topics/environmental-social-governance/2017/Letter-and-ESG-Guidelines.pdf

[15] https://corpgov.law.harvard.edu/2017/02/01/promoting-long-term-value-creation-the-launch-of-the-investor-stewardship-group-isg-and-isgs-framework-for-u-s-stewardship-and-governance/

most important ways of sending that signal to companies and their directors is through the shareholder proposal process.

Benefits to small and individual investors

The shareholder proposal regulatory process allows both small institutional investors and individual shareholders to alert boards to management's need to take timely action on emerging and critical ESG issues.

A system that allows shareholders to file proposals is needed in part because individual investors and smaller shareholders nearly always lack large enough holdings to get the board and management's attention in any other way. As Berle and Means argued in the 1930s, "shareholders often are virtually powerless against management, because each individual shareholder owns only a very small percentage of the outstanding shares…"[16]

The voting process allows one investor to raise an issue, make supporting arguments in the company's proxy materials, educate other investors, and then aggregate the votes of other investors who agree the issue needs to be addressed. Small shareholders filing proposals often catalyze beneficial actions and changes in corporate governance and practices that benefit the company and all shareholders. And many large asset owners and asset managers who rarely file shareholder proposals now vote for ESG proposals filed by smaller shareholders.

For example, in 2016, Walden Asset Management, which manages $3 billion for clients focused on sustainable and responsible investment, filed a proposal with CLARCOR, a water filtration company, requesting a sustainability report including disclosure of greenhouse gas reduction goals. The following asset managers are among those that voted for the proposal, which received 61 percent support: Deutsche, Goldman Sachs, John Hancock, Mass Mutual, Northern Trust, ProShares, Schroders, State Street, TIAA-CREF and Wells Fargo.[17]

In 2016, at least 18 large U.S. mutual fund companies voted for more than 50 percent of climate change-related resolutions, including: Alliance Bernstein, GMO, Lazard, Morgan Stanley, MFS, Natixis, Northern Trust, Schroder, and Wells Fargo.[18]

Corporate directors have limited time and resources. As a result, when they do meet with investors, they generally only meet with the company's largest shareholders, who therefore have a reduced need to submit proposals to get a board's attention. The shareholder proposal process ensures that boards can hear from investors of all sizes. Without this process, boards can be largely insulated from the concerns and perspectives of the wider shareholder base.

[16] The Modern Corporation and Private Property. By Adolf A. Berle, Jr. and Gardiner C. Means. New York: The Macmillan Company, 1932.
[17] According to analysis by Fund Votes
[18] https://www.ceres.org/press/blog-posts/is-your-mutual-fund-company-taking-climate-change-seriously

Benefits to passive and long-term investors

While active investors have the option of selling shares of companies whose management they do not trust to add value, passive investors' options are more limited. BlackRock CEO Larry Fink addresses head-on the benefits of (and need for) shareholder engagement for passive investors:

"BlackRock engages with companies from the perspective of a long-term shareholder. Since many of our clients' holdings result from index-linked investments – which we cannot sell as long as those securities remain in an index – our clients are the definitive long-term investors. As a fiduciary acting on behalf of these clients, BlackRock takes corporate governance particularly seriously and engages with our voice, and with our vote, on matters that can influence the long-term value of firms. With the continued growth of index investing, including the use of ETFs by active managers, *advocacy and engagement have become even more important for protecting the long-term interests of investors."*[19] [Emphasis added.]

Such engagement includes both private company dialogues by large investors like BlackRock and State Street and shareholder proposals by other smaller investors who often find it difficult to get the attention of management and boards through voluntary engagement.

Investors that utilize active management strategies also have a strong interest in engagement and filing shareholder proposals for the same reasons that these investors value the ability to vote their proxies. Active trading can be costly and is ineffective in addressing long-term governance failures at corporations. Most active investors have an interest in the long-term sustainability of corporations they invest in, regardless of their individual portfolio management strategies. Active investors may wish to continue to hold a stock for financial reasons but still maintain concerns about certain governance, risk management or disclosure practices that a shareholder proposal could effectively address. Similarly, active investors that sell a stock today will generally want to be able to purchase that stock again in the future. Their interest in the long-term value of any particular company can be independent of their trading strategies.

It is also important to recognize that while passive investors are unable to sell shares in order to avoid certain risks, active investors are also exposed to the economy-wide systemic risks that shareholder proposals are uniquely positioned to address. Three University of Cambridge research institutions explain this reasoning in their 2015 paper *Unhedgeable Risk: How Climate Change Sentiment Impacts Investment*. The paper argues that: "Short-term shifts in market sentiment induced by awareness of future, as yet unrealised, climate risks could lead to economic shocks, causing substantial losses in financial portfolio value within timescales that are relevant to all investors."[20]

[19] https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter
[20] http://www.cisl.cam.ac.uk/publications/publication-pdfs/unhedgeable-risk.pdf

Benefits and costs to companies

The proposal process is efficient compared to the alternatives

The Business Roundtable states: "As set forth in our 2012 Principles of Corporate Governance, we believe it is the responsibility of the corporation to engage with long-term shareholders in a meaningful way on issues and concerns that are of widespread interest to long-term shareholders, with appropriate involvement from the board of directors and management."[21] For all the reasons described in this paper, the current shareholder proposal process is one of the most effective ways for shareholders to engage the companies in which they invest.

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. Most importantly, any analysis of costs (discussed below) of the proposal process must be balanced against the benefits. Poor corporate governance and inadequate ESG practices hurt company performance and investor returns, sometimes in catastrophic ways, as described above.

Companies frequently agree to act on the request made in the proposal

Many shareholder proposals result in agreements between the filing shareholder and the company. An average of 37.5 percent of shareholder proposals related to climate change during the 2012-2016 proxy seasons were withdrawn by filers in response to the company agreeing in some form to the request. Withdrawal rates for some other topics is far higher. The New York City Comptroller's Office withdrew 80 percent of the 45 proxy access resolutions it filed during the 2016 and 2017 proxy seasons due to commitments by 36 companies. These examples of high 'agreement rates' suggest that many companies find benefits in committing to act on shareholder proposals before they go to a vote.

The cost to companies is generally low and spending is within their control

The Business Roundtable suggests that companies spend an average of about $87,000 per shareholder proposal.[22] This figure originates from an SEC release in which the SEC attempted to utilize limited and ambiguous data to calculate costs associated with the shareholder proposal process. Prior to its 1998 rulemaking, the SEC surveyed companies regarding the costs of the process. The questionnaire contained ambiguous questions yielding results that do not support the above figure.

First, the SEC asked how much it costs companies per year to determine whether or not to include shareholder proposals, including following the exclusion rules and procedures. Because the question was ambiguously worded, the average figure of $37,000 per year arguably applied to the total cost to companies of considering whether or not to include all proposals. It did not appear to

[21] http://businessroundtable.org/resources/letter-sec-rule-shareholder-proposal-resubmissions
[22] https://www.sec.gov/comments/4-537/smbainbridge7785.pdf; https://www.uschamberfoundation.org/sites/default/files/article/foundation/Analysis%20of%20the%20Wealth%20Effects%20of%20Shareholder%20Proposals_0.pdf

reflect the cost per proposal. The wide range of responses to the question from $10 to $1,200,000 (a median value of $10,000) also reflects the ambiguity of the issue and question, as well as the range of resources expended by companies in their discretion in response to shareholder proposals. Similarly, the SEC reported survey results indicating an average cost of $50,000 to publish proposals, and as with the first question it appeared that this may be the average cost for including all proposals in the proxy, rather than a per proposal expense.[23] These ambiguities in the original questionnaire and responses undermine the conclusion that it costs companies an average of $87,000 per proposal.

Most companies receive few, if any, shareholder proposals. While there are about 4,000 publicly listed companies in the U.S. (excluding over-the-counter stocks)[24], in 2016 approximately 1,000 resolutions were filed[25] – or approximately 1 proposal every 4 years per company on average.[26] Moreover, most proposals tend to be filed with larger (i.e., S&P 500) companies, which have the resources to deal with such shareholder input. The number of shareholder proposals in recent years has not been significantly increasing. Rather the number of proposals has vacillated from a high of 1,126 in 2009 to a low of 691 in 2011.[27]

Finally, the SEC oversees a robust "no-action letter" system that allows companies to exclude proposals from the proxy ballot that do not meet certain procedural and/or substantive hurdles. Requesting an informal no-action letter provides companies with a means of knowing whether the SEC Staff would recommend no enforcement action if the company's excludes the proposal from the proxy. During the 2013-2015 proxy seasons companies challenged nearly one-third of shareholder proposals submitted. About half of those challenged proposals were omitted from the proxy with SEC approval.

Studies show financial performance benefits to companies receiving resolutions and for strong ESG performance

A substantial body of literature shows that companies that have superior sustainability or ESG performance perform at least as well as, and often better than, less sustainable peers. Thus, issues raised in shareholder proposals are often financially material to companies.

- A recent analysis of more than 2,000 empirical studies concluded that approximately 90 percent of those studies found that the relationship between ESG and financial performance was either positive or zero. Only ten percent of the studies showed a negative relationship. Morningstar's research from 2015 shows that large-cap U.S. funds with high Morningstar Sustainability Ratings have lower risk.[28]
- A 2015 study found that successful ESG engagements generate cumulative (1999-2009) excess returns of +7.1 percent. Moreover, unsuccessful engagements (ones that didn't result

[23] https://www.sec.gov/rules/final/34-40018.htm
[24] http://money.cnn.com/2015/07/09/investing/stock-market-shrinking/
[25] Data provided by the Sustainable Investments Institute.
[26] ISS Voting Analytics database.
[27] http://static1.1.sqspcdn.com/static/f/276323/27013100/1462553848273/J+Brown_THE+EVOLVING+ROLE+OF+RULE+14A-8+IN+THE+CORPORATE+GOVERNANCE+PROCESS.pdf?token=eOvll5sXwVYJld48V6JQYXw1OuA%3D P. 181
[28] Higher Sustainability Ratings Can Mean Lower Risk Jon Hale, Morningstar, October 13, 2015

in any corporate action) experienced no change in market value.[29] This suggests that while proposals that lead to corporate action on an ESG issue can be significantly beneficial for companies and shareholders, proposals that don't lead to action cause no harm.

- A 2014 study that tracked two groups of companies (categorized as high / strong or low / weak on sustainability) between 1993 and 2009 found that high sustainability companies significantly outperformed their counterparts over the long-term in terms of stock market and accounting performance.[30]
- A recent study by Wilshire of the effect of CalPERS' corporate governance activism on targeted company share prices shows that, for the three years prior to the engagement, targeted companies significantly underperformed the Russell 1000 index, while for the five years following the engagement, they significantly outperformed the same index.
- An academic study conducted in 2016 found that "[F]irms that adopted shareholder resolutions on long-term [executive] compensation experienced a significant increase in their stock price.... Overall, the findings of this study suggest that long-term incentives improve a firm's governance as well as its impact on society and the natural environment."[31]
- Additional studies are available here.

The current rules and thresholds are appropriate and should be maintained

As mentioned earlier, the current proposal process has been refined and fine tuned since 1943, and works well in its current form. The existing process is flexible, allowing investors to tailor their requests to address company-specific issues as they arise. As a result, the proposals filed each year reflect market conditions and evolving best practices. These benefits are closely related to the specific thresholds and criteria in Rule 14a-8, which we believe should be maintained.

The value of existing filing thresholds

Under the current SEC rule, to submit a proposal, investors most hold at least $2,000 worth of shares continuously for at least one year. The one year holding requirement ensures that the use of the shareholder proposal rule is appropriately limited to longer-term shareholders. For example, the current tax code also uses one year to distinguish short-term capital gains from long-term gains.

Any proposals to significantly increase the filing threshold would exclude many smaller investors from filing. This raises serious fairness and efficacy concerns. For example, religious organizations are long-time leaders in filing constructive shareholder proposals. Some of these filers are very small investors who would be forced out of the system if the filing threshold were raised significantly. Large investors do not have a monopoly on good ideas, and they already have greater access to boards than smaller investors, as previously described. The current shareholder

[29] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
[30] http://pubsonline.informs.org/doi/abs/10.1287/mnsc.2014.1984
[31] https://irrcinstitute.org/wp-content/uploads/2016/12/2016-Academic-Winner-by-Flammer1.pdf

proposal system harnesses the power of a marketplace of ideas, and barring small investors from participating in this marketplace would be as unwise as it is unfair.

Prior to 1983 there was no dollar threshold for submitting a proposal. In 1983 the SEC adopted a $1,000 requirement. In 1998 the SEC raised the threshold to $2,000.[32] They declined to raise the threshold further "out of concern that a more significant increase would restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders."[33] If the amount were adjusted for inflation since 1998 the current threshold would increase to about $2,946.[34] Therefore, the existing filing threshold is close to what the SEC felt in 1998 was necessary to avoid excluding smaller shareholders.

The value of existing resubmission thresholds:

In order to resubmit a proposal under current rules, it must have received at least 3 percent of the vote on its first submission, 6 percent on the second and 10 percent on the third. The BRT has proposed that at <u>the very least</u> the thresholds should be updated to implement the increases proposed in 1997: 6 percent on the first submission, 15 percent on the second and 30 percent on the third. The percentage of proposals since 2000 that are estimated to fall below those thresholds are 13.32%, 31.5%, and 50.14%, respectively.

As noted above, experience indicates that it often takes several years for a proposal on an emerging issue to gain traction with investors and to achieve double-digit votes. In many instances these proposals eventually receive substantial support, leading to widespread adoption by companies. The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

It is also important to keep in mind the following, which can contribute to low votes on shareholder proposals:

1. Some companies have high insider ownership and insiders can be expected to vote with management;
2. Companies can use multiple share classes that can reduce votes;
3. Broker non-votes and abstentions can be used to reduce vote percentages if they are added to denominator when votes are calculated. The great majority of firms use the simple formula "For / For + Against" when calculating votes, which is the method used by the SEC for assessing whether resubmission thresholds have been met;
4. A few of the very largest asset managers still routinely vote against (or abstain from voting on) all resolutions with environmental and social elements.

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[32] https://www.sec.gov/rules/final/34-40018.htm
[33] https://www.sec.gov/rules/proposed/34-39093.htm
[34] https://www.bls.gov/data/inflation_calculator.htm

Existing SEC rules preclude proposals relating to 'ordinary business'

The SEC's current guidance on allowing companies to exclude from the proxy any resolutions pertaining to a company's ordinary business appropriately states that resolutions need to pertain to "significant policy issues" faced by companies.[35] This approach strikes a critical balance between respecting the board's role on corporate governance and management's discretion on routine business decisions, while also recognizing the existence of policy issues significant enough to warrant a shareholder vote.[36]

As Staff Legal Bulletin No. 14E (2009), made clear, a primary benefit of the shareholder resolution process is the ability for investors to help companies address issues that are currently (or may soon become) significant risks that are not widely recognized or appreciated by the company. Resolutions focusing on risks are among the most critical examples of how the private ordering system of the proposal process should work. Investors must be permitted to focus the board and management's attention on unaddressed risks. This system harnesses market forces by allowing shareholders to highlight risks their companies face and ask the companies to act to reduce the risks.

SEC rules to prevent abuse of the system by special interests

Under existing SEC rules, the voting process prevents undue influence from special interests as well as frivolous resolutions. The SEC's "no-action letter" system relies on rules that bar proposals: pertaining to "personal interests;" relating to operations accounting for less than 5 percent of gross sales; "that the company would lack the power or authority to implement;" dealing with "ordinary business operations;" that the company has "already substantially implemented;" or that "relates to specific amounts of cash or stock dividends."[37]

Any resolutions that survive the no-action process but subsequently generate low votes are then excluded by the current resubmission thresholds. Under this part of the system, decisions about what should go on the ballot are primarily in the hands of voting investors. As Matt Orsagh, a corporate governance expert with the CFA Institute, told Bloomberg BNA, "We prefer to let investors decide for themselves whether a proposal is worthy of their time."[38]

Conclusion

It is not surprising that corporate managers and their trade associations may not see the materiality of corporate governance and ESG issues in exactly the same light as investors. The median CEO tenure at S&P 500 companies as of 2014 was six years.[39] Generally speaking, CEOs can be expected to try to maximize share prices and returns during their tenure, a reality partially

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[35] Staff Legal Bulletin No. 14E: https://www.sec.gov/interps/legal/cfslb14e.htm
[36] https://www.sec.gov/interps/legal/cfslb14h.htm and Medical Committee for Human Rights v. SEC, 432 F. 2d. 659, 680-681 (1970), vacated and dismissed as moot, 404 U.S. 402 (1972).
[37] https://www.sec.gov/interps/legal/cfslb14.htm
[38] https://www.bna.com/us-chamber-calls-n57982063976/
[39] http://www.equilar.com/blogs/59-ceo-tenure.html

responsible for the so-called "tyranny of short-termism."[40] But investors saving for retirement and other long-term shareholders have much longer-term interests.

These long-term perspectives can also be helpful to company financial performance. A 2014 study of the effect of long-term investors on corporate decision-making shows that "long-term investors restrain numerous corporate misbehaviors such as earnings mismanagement and financial fraud…" and foster shareholder input into board and management decisions.[41]

The shareholder resolution process allows investors to ask boards and management to address issues that affect the long-term interests of investors. At the same time, the existing process allows companies to exclude frivolous resolutions, those that seek to micro-manage, or that intrude on management's ordinary business judgment. Through use of precedent, the existing no-action letter process sends strong signals to resolution filers to avoid filing resolutions that are likely to be excluded, thereby enhancing the efficiency of the system.

The resolution process provides a needed and effective tool to the growing ranks of passive index investors who often cannot divest shares when they have concerns about corporate governance and other ESG issues. But their fiduciaries can use shareholder proposals to influence the behavior of boards and management and encourage companies to address material corporate issues. And the votes of their fellow investors can send a powerful signal about the importance of these issues to investors. Hence shareholder proposals provide a valuable service to all shareholders, allowing them to signal boards and management in an advisory capacity.

The current U.S. shareholder proposal system provides important benefits for investors and companies. It is a key tool for the assertion of shareholder rights, helps ensure accountability of boards and management, and enables shareholders to focus corporate attention on important issues that may otherwise escape attention. Changing the existing finely tuned SEC rules and practices for overseeing shareholder proposals is likely to do much more harm than good.

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[40] https://hbr.org/2011/03/capitalism-for-the-long-term
[41] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2505261