Shareholder Rights Group

Shareholder Rights Group

Arjuna Capital

As You Sow

Boston Common Asset Management, LLC

Boston Trust Walden

Clean Yield Asset Management

First Affirmative Financial Network, LLC

Harrington Investments, Inc.

Jantz Management, LLC

John Chevedden

Natural Investments, LLC

Newground Social Investment, SPC

NorthStar Asset Management, Inc.

Pax World Funds

Sustainability Group of Loring, Wolcott & Coolidge, LLC

Trillium Asset Management, LLC

January 6, 2020

Hon. Jay Clayton, Chairman
Hon. Robert J. Jackson Jr., Commissioner
Hon. Allison Herren Lee, Commissioner
Hon. Hester M. Peirce, Commissioner
Hon. Elad L. Roisman, Commissioner
Vanessa A. Countryman, Secretary
US Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

RE: Comments on Proposed *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8* (File Number S7-23-19) and *Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice* (File Number S7-22-19)

Dear Chairman Clayton and Commissioners Jackson, Lee, Peirce and Roisman,

I am writing today on behalf of the Shareholder Rights Group. The Shareholder Rights Group is an association of investors formed in 2016 to strengthen and support shareowners' rights to engage with public companies on governance and long-term value creation.

On November 22, 2019, we wrote to urge the Commission to extend the comment deadline for the above-referenced rulemaking proposals. Today, we are submitting our first in a series of substantive comments on the rulemaking proposals on Proxy Advisors and Shareholder Proposals: "Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8" (File Number S7-23-19) and "Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice" (File Number S7-22-19).

While there are certain limited provisions within the rulemaking proposals that we can support (such as encouraging baseline disclosures by proxy advisors, issuers, and shareholders), we believe the core provisions of *both* proposed rule changes would be harmful to the interests of investors, pose systemic risk, and jeopardize progress on sustainable and responsible business practices in the U.S. and global economy. We therefore urge the Commission to fully reject, and take no action on, the proposed rules.

SUMMARY

This letter focuses on the investor value at risk from the proposed resubmission threshold changes, as well as the interplay between those proposed resubmission threshold revisions and the proposed proxy advisors rule.

Application of the SEC's own guidelines for economic analysis necessitates that the Commission take no action on the proposed rules. The proposal fails to make any attempt to estimate the immense value that would be foregone by cutting back on options for shareholder recourse if these rules are adopted. The body of research on the environmental social and governance (ESG) issues that are the focus of shareholder resolutions clearly demonstrate the value of improved ESG disclosure and performance on long term value and in risk management. below we offer examples in which the application of the new rules to recent proposals at Boeing, Wells Fargo and Chevron, would have been denied investors their fundamental rights to press for changes on matters that exposed companies and their investors to billions of dollars of risk and losses. The impact of such exclusions demonstrates that the alternative of taking *no action* on the proposed rules is the economically superior alternative, by orders of magnitude.

In our assessment, the combined effect of both rule changes would be to disrupt the functional ecosystem of working relationships between shareholder proponents, institutional investors, proxy advisors and public companies. This ecosystem of relationships contains an established path for improving risk management and governance, as well as ESG disclosure and performance in the market. The proposed rule changes would make the path of investor engagement steeper and more convoluted – adding unnecessary costs and red tape, and making it more difficult for investors to foster sustainability, prudent risk management, and governance improvements at their companies.

Making such changes at a time when investor demand for ESG disclosure and performance is on the rise seems an arbitrary and inappropriate approach to rulemaking. Furthermore, the proposed rules lack economic justification. Because the current ecosystem largely runs efficiently and effectively, the rulemaking package appears to be a solution in search of a problem.

At stake is a core right of minority investors to participate in dynamic corporate governance, and the ability of shareholders of all sizes to help grow and protect America's long-term investments, retirement funds and the economy through thought leadership, risk management, and improved governance. Many of the largest index investors (representing the largest blocks of voted shares) face economic incentives to underinvest in stewardship, defer excessively to the preferences and positions of corporate managers[1] and seldom, if ever, file shareholder proposals. This is why smaller investors that seek to actively protect their investments through the shareholder proposal process play a critical role in the governance and risk management ecosystem.

[1] Bebchuk, Lucian A., and Hirst, Scott, "Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy", *Columbia Law Review*, Vol. 119, 2019.

Indeed, the shareholder proposal process administered by the SEC plays a pivotal role in reconciling the interests of management and investors, between controlling and minority investors, and between investors concerned with short-term and long-term value creation. The Commission's proposed rules would insulate corporate boards and CEOs from the valuable perspectives of shareholders and other stakeholders. The rulemaking would also hamstring shareholder proponents and proxy advisors by imposing procedural requirements that would sharply increase the cost of filing shareholder proposals and of providing proxy advisory services.

The SEC's release detailing the proposed shareholder proposal rulemaking estimates that the changes to the shareholder proposal rule alone would reduce the number of shareholder proposals considered at annual meetings by 37%, and across the entire range of Russell 3000 companies save a maximum of $70.6 million annually in corporate expenses. However, this purported savings is illusory, as reducing shareholder proposal submissions and resubmissions by over one third each year will also put at risk the significant value that is offered by engagement supported by shareholder proposals. In fact, this value placed at risk is not assessed in the rulemaking proposal's economic analysis, even though it is orders of magnitude larger than the purported savings. While engagements are often qualitative in nature, the evidence is clear: consultations between investors and companies on ESG issues lower agency problems, improve disclosure which is essential for well-functioning markets, and reduce downside risk.[2] The proposed rules that diminish the capacity of small investors to file proposals will reduce the level of stewardship in the market. The impact extends beyond the companies where proposals are excluded, since support for proposals also signals other companies to adopt the "best practices" modeled in proposals, without the need for receiving shareholder proposals.

This letter seeks to elucidate the potential negative ramifications and costs to shareholders and the market of the proposed steep increases to resubmission thresholds. We examine several instances in which the currently proposed revisions to resubmission thresholds, if applied in the past, would have effectively marginalized issues and disallowed shareholder recourse on matters that are now pivotal to the companies' futures. These examples epitomize the challenging issues of corporate fiscal and social responsibility:

- Chevron's efforts to come into alignment with the demands of climate change;

- Wells Fargo's failure to establish a culture, set of values, and ethics that consistently respect its consumers and protects them from widespread fraud;

- Boeing's experience with the 737 MAX jet and related lobbying efforts, which led to a dangerous environment of self-regulation.

In each instance, the path of effective, deliberative responses to major issues raised by

[2] See, e.g. Hoepner et al, ESG Shareholder Engagement and Downside Risk. *AFA 2018 paper* http://www.q-group.org/wp-content/uploads/2018/02/SHAREHOLDER-ENGAGEMENT-2018-01-31.pdf

investors, and the vital role of shareholder proposals, would have been thwarted if the proposed rules on resubmission were then in effect.

In addition, we are concerned that the combined effect of the resubmissions rule with the proposed proxy advisory rule, which effectively constitutes a "tax" on opinions adverse to management's, could serve as pressure to reduce the number of favorable proxy advisor recommendations on shareholder proposals. If this consequently depressed voting outcomes, it would further escalate the number of excludable proposals.

ESG disclosure and performance has become well-understood by investors and analysts as a key benchmark against which long-term value creation and performance can be tracked and enhanced. As a result, both ESG and mainstream investors are increasingly supporting shareholder proposals on these issues, many of which could be blocked by the proposed rulemaking.[3]

Accordingly, in its economic and policy analysis, we recommend that the Commission consider the depth and breadth of value at risk and losses to investors and companies that would result from the adoption of the two proposals. We recommend this consideration include the economic impact related to:

- the *risk of governance failures that jeopardize billions or trillions of dollars in value, including* existential risk to companies, and systemic risks;

- the value gained from *disclosure* on issues of concern to an increasingly large and continually growing segment of investors, including mainstream investors who now recognize the importance of ESG to prediction of long-term value;

- the value of shareholder *engagement* that is derived from addressing issues of long-term value creation and ESG matters through private ordering;

- the value of the *investor deliberative process* that would be truncated or abandoned if the proposed rules are implemented;

- the value of *market-wide private ordering* that extends beyond the individual issuers receiving proposals to effect change across the market;

The proposed rulemaking not only undermines the right of investors to file shareholder proposals; it also undermines the rights and ability of investors to vote on ESG-related proposals and to send important signals to boards and management on their investors' perspectives.

[3] For instance, a Morningstar analysis reported in Institutional Investor found that voting support of ESG proposals by mainstream fund is on the rise, due to the clear connection to financial value. Julie Segal, "The Surprising Firms Leading the Way on ESG," *Institutional Investor*, Dec. 17, 2019. https://www.institutionalinvestor.com/article/b1jhp9p4cqn1bh/The-Surprising-Firms-Leading-the-Way-on-ESG-Votes

ANALYSIS

PART I: PROPOSED INCREASES TO THE RESUBMISSION THRESHOLDS WOULD OBSTRUCT INVESTOR RECOURSE AND ENGAGEMENT ON KEY CORPORATE RESPONSIBILITY ISSUES.

The rulemaking proposal on resubmissions would sharply curtail shareholder proposals that are directed to protecting long-term investor value, by placing more stringent hurdles to progressing along an effective, deliberative path to voting support. As demonstrated in the examples below, a review of material ESG issues facing some of America's largest companies demonstrates that the current resubmission levels of 3%, 6%, and 10% votes to submit proposals in the first, second, and third year of voting currently provides an effective pathway to proposal consideration and support -- sometimes over as many as 6 or 7 years. Votes fluctuated during those times, with percentages sometimes dropping close to the current thresholds. Increased thresholds would have truncated discussion prematurely.

Ultimately, the long-term success of any shareholder proposal, whether filed by retail investors or institutions, may depend on being able to make a strong business case to other shareholders. If a proposal does not win a baseline of support from fellow shareholders, the existing rule already removes the topic from the company's annual meeting agenda for three years. In contrast, if a proposal sustains at least 10% support, the level of further support may abruptly change in a subsequent year with the evolution in market conditions, disruptive developments, policy making, and investing strategies. Most importantly, decisions by larger shareholders to support a proposal often occur only after a proposal is seen as more than a "flash in the pan," i.e. once it has persisted long enough for slower moving, larger investment firms to assess the fiduciary arguments for support and establish a voting policy relevant to the specific issue raised.

Thus, the resubmission thresholds of Rule 14a-8 allow for an ongoing and evolving deliberative process in the ecosystem of investors expressed through education, policy development, engagement, and persistence. Sometimes, the subject matter of a proposal may linger on the proxy for a course of years before becoming widely supported.

Example 1. Chevron: Investor Efforts to Address Methane and Climate Change Would Have Been Obstructed by Proposed Rule Changes

Market-wide Climate Change Risk Management Focus

Climate change is an existential issue for the human race, global economies, the United States, issuers, and their investors. From 2015-2018, the world experienced a series of unprecedented extreme weather events, of the kind anticipated to occur with greater frequency as a result of climate change. In October 2018, the Intergovernmental Panel on Climate Change

(IPCC) released a report, “Summary for Policymakers of IPCC Special Report on Global Warming of 1.5°C approved by governments,” reassessing the trajectory of global warming, and outlining the large difference in damage to habitability of the earth caused by relative increases of temperature – the difference between 1.5°C and 2°C.

It has been estimated that $30 trillion in global damages is at risk, and that this loss can be avoided by maintaining warming under 1.5°C rather than 2°C.[4] The capital markets have begun to register and implement this mandate by including carbon risk in portfolio analysis and, through engagements with issuers, requesting disclosure and improved performance in aligning company emissions with the global climate goal.

A state of the industry report, “Tipping Points 2016,”[5] collected data from a group of 50 institutions, including 28 asset owners and 22 asset managers selected based on their diversity. The report found that institutional investors (1) consider and manage their impacts on environmental, societal, and financial systems, and (2) consider those systems’ impacts on their portfolios, with financial returns and risk reduction being two primary motivators for approaching investment decisions on a systemic basis. The report shows asset owners not only consider the financial risks they perceive from ESG issues at the level of specific securities and industries, but are also concerned with measuring and managing climate risk on a portfolio-wide basis.

Nowhere is this truer than with climate change. Investor portfolios commonly hold investments from a wide spectrum of economic sectors, all of which may be affected by climate change given that the combined effect of climate change across the economy is projected to have substantial negative, long-term, portfolio-wide implications. Due to the gravity and urgency of this issue, shareholder proposals addressing climate change are now commonplace on proxy statements.

In the U.S., advancement on corporate climate initiatives has been driven to a large degree by shareholder proposals and shareholder engagement. The current rulemaking proposals, had they been in effect during the last decade, would have thwarted many important climate proposals.

Proposed Resubmission Rules Would Have Blocked Productive Engagement on Methane at Chevron

One informative example is the progression of 2015-2018 hydraulic fracturing and methane proposals at Chevron. In 2018, approximately 45% of Chevron’s shareholders voted in favor of a fugitive methane reduction resolution[6] put forward by shareholder advocate As You

[4] Damian Carrington, "Hitting toughest climate target will save world $30tn in damages, analysis shows", The Guardian, May 23, 2019. https://www.theguardian.com/environment/2018/may/23/hitting-toughest-climate-target-will-save-world-30tn-in-damages-analysis-shows.

[5] State of the Industry Analysis: Tipping Points 2019. The Investment Integration Project. http://tiiproject.com/tiiping-points-2016.

[6] *Chevron Corporation: Request for Report on Methane Leaks.* As You Sow, December 31, 2017.

Sow and co-filers. As You Sow is a nonprofit organization that promotes environmental and social corporate responsibility through shareholder advocacy, coalition building, and innovative legal strategies. The proposal highlighted Chevron as one of the top methane emitters, ranking 17th out of the highest 100 methane emitters[7] from onshore production while also noting its failure to keep up with peers in reporting its methane reduction actions. The resolution underscores the need for the company to better monitor, mitigate, and reduce its methane emissions in light of the significant climate change impact of methane, a powerful greenhouse gas that "warms the planet by 86 times as much as CO2."[8]

In anticipation of the vote on the shareholder proposal to be considered at the company's 2018 annual meeting, the company began to announce new measures to address methane management. For the first time, Chevron provided an intensity rate for its methane emissions in its Corporate Responsibility Report.[9] It also signed on to oil & gas industry "Guiding Principles"[10] for reducing methane emissions from across the natural gas value chain. This voluntary initiative was previously signed by several peer global oil & gas companies, highlighting the importance of methane emissions.

Because of earlier engagements with Chevron that experienced significant shareholder support without commensurate company action, **the 2018 proposal – which nearly received a majority vote – would have been excluded had the currently-proposed resubmission thresholds been in place**.

The 2018 proposal related to the company's actions beyond regulatory requirements to minimize methane emissions, particularly leakage, from the company's hydraulic fracturing operations,[11] but this was not the first instance in which shareholders supported a climate-change related proposal at Chevron. In 2011, a similar proposal on hydraulic fracturing had received 40% of shareholder support; in response, the company took modest actions on the issues, which resulted in a slight decline in voting support to a low of 26.6% in 2014. Despite still representing a significant portion of shareholder votes, this vote level would have triggered the new proposed momentum exclusion. By 2016, shareholder support rebounded to 30.7% and then in 2018 to 45% – illustrating the ebb and flow of shareholder voting patterns. The 2018 methane proposal echoed many of the themes of earlier hydraulic fracturing proposals. Therefore, it is reasonable

---

https://www.asyousow.org/resolutions/2017/12/31/chevron-corporation-request-for-report-on-methane-leaks

[7] *The Who's Who of Methane Pollution in the Onshore Oil and Gas Production Sector*. Alison Cassady, Center for American Progress. June 20, 2016.
https://cdn.americanprogress.org/wp-content/uploads/2016/06/17113709/MethanePollution-report.pdf

[8] Gayathri Vaidyanathan, "How Bad of a Greenhouse Gas is Methane?", E&E News, December 22, 2015.
https://www.scientificamerican.com/article/how-bad-of-a-greenhouse-gas-is-methane/

[9] *Chevron 2017 Corporate Responsibility Report Highlights—Human Energy.*
https://www.chevron.com/-/media/shared-media/documents/2017-corporate-responsibility-report.pdf

[10] *Reducing Methane Emissions Across the Natural Gas Value Chain - Guiding Principles.* Climate and Clean Air Coalition. November 2017. https://ccacoalition.org/en/resources/reducing-methane-emissions-across-natural-gas-value-chain-guiding-principles.

[11] Proponents request in the supporting statement that the report include: Identifying how frequently leak detection methodologies, beyond compressors, etc., including equipment inspected, repair times for identified leaks, status of reducing high bleed pneumatic devices, methane emission rates from drilling, completion, and production operations and methane emissions reduction targets.

to conclude it could have been excludable in 2019 under Rule 14a-8(i)(12), because it addressed an issue which had "lost momentum", thus cutting off this productive investor engagement process in a critical time period.

Chevron Shareholder Proposals on Hydraulic Fracturing and Methane			
Year	Vote Level	Existing Threshold	Proposed Threshold
2011	40.5	3	5
2012	27.9	6	15
2013	30.2	10	25
2014	26.6	10	Momentum drop of more than 10%
2015	26.8		**Excluded**
2016	30.7		**Excluded**
2018	45.0		**Excluded**

Example 2. Wells Fargo & Co.: Investor Efforts to Reform a Predatory Corporate Culture Would Have Been Obstructed by Proposed Rule Changes

Before Wells Fargo gained notoriety for a corporate culture and incentive system that drove pervasive fraud targeting its retail consumers, shareholder proponents had been aggressively raising concerns regarding the company's predatory culture through the shareholder proposal process. If the proposed resubmission rules had been in effect, several of the relevant shareholder proposals, including one pending for the 2020 proxy season, would have been thwarted. In contrast, if the Board and management had heeded the early warnings by shareholder proponents, billions of dollars in losses might have been averted.

Investors Anticipate Predatory Practices at Wells Fargo

In late 2016, the extent of consumer fraud at Wells Fargo became international news when it was revealed that company associates had created several million deposit and credit card accounts for clients without their permission. However, long before the company lost billions of dollars of value with its reputation plummeting due to egregious anti-consumer practices, shareholders had raised concerns about the company's predatory lending practices.

Beginning at least as early as 2004, the company received shareholder proposals on predatory lending. For instance, in 2004 a proposal by NorthStar Asset Management requested that the Board conduct a special executive compensation review to study ways of linking executive compensation to successfully addressing predatory lending practices. Then in 2009, a shareholder proposal asked for a report "evaluating, with respect to practices commonly deemed to be predatory, the company's credit card marketing, lending, and collection practices, and the impact these practices have on borrowers"; SEC staff agreed with the company's assertion that this was excludable as a matter of ordinary business for the company, and that proposal was

excluded from the proxy. *Wells Fargo and Company* (February 11, 2009). While the company dismissed 5,300 employees in the aftermath of the 2016 scandal, observers have suggested that the cultural problems represented a hard-to-repair ethical failure embedded at a policy level within the company.

As of 2011, the Staff began to ease the restrictions on related proposals — allowing a proposal requesting that the Board have its Audit Committee conduct an independent review of the Company's internal controls related to loan modifications, foreclosures, and securitizations, and report to shareholders. In subsequent years, related proposals also sought an independent review of the Company's internal controls to ensure that its mortgage servicing and foreclosure practices did not violate fair housing and fair lending laws, and report its findings and recommendations. **Yet, examination of the voting records of those proposals on predatory lending in the early 2010s shows that under the proposed resubmission rule, proposals on the same subject matter would have been excludable in 2013 and for three years thereafter – a critical period – due to their failure to reach the 15% threshold in 2012.**

Wells Fargo & Co. Shareholder Proposal on Home Mortgage Policies			
Year	Vote Level	Existing Threshold	Proposed Threshold
2011	22.8	3%	5%
2012	6.4	6%	15%
2013	24.8	10%	Excluded
2014	20.1		Excluded

Independent board chair proposal would have been excludable

In the face of this Wells Fargo consumer fraud crisis, in 2017 the company finally acceded to long-standing shareholder proposal requests that the company separate the CEO and board chair positions. Shareholders had sought this governance reform for 10 years. Relevant to the current rulemaking, the voting support levels for independent chair shareholder proposals over that time had achieved a high of 37.8% in 2012 and dipped to a low of 16.4% in 2015. However, as the news of the fictitious account fraud became well-known late in 2016, the crisis at the company brought a turnaround in shareholder support. The Needmor Fund and Connecticut Retirement Funds filed the 2017 resolution seeking an independent board chair.

This resolution would not have been permitted from 2014-2016 under the proposed thresholds, due to loss of momentum and votes below 25% in the years preceding. Yet, in this instance, with the filing of the 2017 proposal, the bank immediately commenced negotiations with the sponsors and agreed to appoint an independent board chair leading to the withdrawal of the proposal; clearly a win-win agreement. The Wells Fargo Board eagerly agreed to make this governance change as they tried to regain public credibility. If the crisis had peaked a year earlier, investor recourse through the shareholder proposal process that led to the independent board chair would have been blocked if the proposed rule were in effect. Given that the company made this change in response to a shareholder proposal, it is unclear how eager the company would have been to negotiate on this particular governance issue if it had been an excludable

topic due to resubmissions thresholds.

Wells Fargo & Co. Shareholder Proposal on Independent Board Chair			
Year	Vote	Existing Threshold	Proposed Threshold
2010	26.9	10*	25
2011	29.9	10	25
2012	37.8	10	25
2013	22.0	10	Loss of momentum
2014	16.4	10	Excluded
2015	16.4	10	Excluded
2016	17.2	10	Excluded
2017	***Proposal fulfilled by Wells Fargo; withdrawn by shareholders***		Eligible for resubmission based on cooling off period

* A similar proposal was also considered in years prior to 2010, so that the 10% third year threshold was applicable.

Dialogue with investors and stakeholders prompted by shareholder proposal process

As Wells Fargo continues to rebuild its reputation from "one of the ugliest banking scandals in an era full of them,"[12] faith-based and other investor groups continue ongoing dialogues to seek fundamental reforms at the company. These dialogues have been spurred by shareholder proposals filed by investors for over ten years. The Sisters of St. Francis of Philadelphia ("the Sisters") is one such group of engaged Wells Fargo investors. Notably, in addition to being investors, this church group maintains a Wells Fargo account that is accessible to all members across the United States, making for a dual relationship as both investors and customers.

The Sisters are transparent in their critique. In their Exempt Solicitation Letter supporting a shareholder resolution filed in 2017, the Sisters urged votes for the proposal "***because Wells Fargo is exposed to significant risks due to lapses in vision, values, ethics and culture; Wells Fargo has not adequately assessed and managed those risks, and Proponents seek a systemic, comprehensive approach to address business standards, through disclosure which demonstrates meaningful and authentic implementation of policies and practices to effectively reduce risk.***"[13] The resolved clause of a 2017 proposal that preceded the company's issuance of a Business Standards Report read, "**RESOLVED:** *Shareholders request that the Board*

[12] "Wells Fargo: repairing a damaged brand", *Financial Times*, https://www.ft.com/content/b858da70-1418-11e9-a581-4ff78404524e.

[13] Notice of Exempt Solicitation, The Sisters of St. Francis of Philadelphia, March 29, 2017, page 1.

commission a comprehensive report, available to shareholders by October 2017, on the root causes of the fraudulent activity and steps taken to improve risk management and control processes. The report should omit proprietary information and be prepared at reasonable cost."

Sister Nora Nash, Director of Corporate Social Responsibility for the Sisters of St. Francis of Philadelphia, explained the importance of their continued engagement as investor-customers: "To align with the bank's stated goals of transparency and remediation, we will continue to engage with the bank on all aspects of this report while still asking for evidence of one corporate culture that is consistent across all business lines… Given the nature of the harm that has been caused and the serious erosion of trust, Wells Fargo will need to rebuild the trust and confidence of its team members, customers, and investors by providing evidence that demonstrates the changes have begun."[14]

As long-term investors in Wells Fargo, the Sisters and other shareholders engaged in dialogue historically with the company, and continue to engage now with the purpose of protecting their investment – as well as the investment of fellow shareholders – by alerting the company to the risks associated with issues such as the pervasive corporate culture problems observed at Wells Fargo.

Pending 2020 Proposal on Wells Fargo Incentive Structure Excludable in Proposed Rule

The crisis at Wells Fargo has persisted into recent years and the company continues to suffer a prolonged crisis of public, government, and consumer trust, having paid over $17.2 billion in penalties since 2000. In addition to the aforementioned revelation of the establishment of 3.5 million fictitious or unauthorized accounts, Wells Fargo has also admitted to improper practices in which 800,000 people were forced to take redundant auto insurance from 2012 to 2017. The Federal Reserve has capped the bank's assets, ordered the Company to replace four directors, and cited "widespread insurance abuse." The Consumer Financial Protection Bureau and the Office of the Comptroller of the Currency settled for $1 billion in a case alleging failure to manage risk, and the United States Department of Justice settled for $2 billion over mortgage backed securities originated by Wells Fargo.

One ongoing element of investor concern relates to the incentive structures at Wells Fargo which may have inspired so many fraudulent transactions. A proposal that has been filed for several years by the New York State Common Retirement Fund seeks an independent assessment of the incentive structure for employees.[15] Even though the proposal goes to the heart

[14] "Wells Fargo: Learning from the Past, Transforming the future", The Sisters of St. Francis of Philadelphia. https://osfphila.org/corporate-social-responsibility/active-actions/wells-fargo-learning-from-the-past-transforming-the-future-still-questionable/.

[15] The proposal requested that the Board prepare a report, at reasonable cost, disclosing to the extent permitted under applicable law and Wells Fargo's contractual, fiduciary or other obligations (1) whether and how the Company has identified employees or positions, individually or as part of a group, who are eligible to receive incentive-based compensation that is tied to metrics that could have the ability to expose Wells Fargo to possible material losses, as determined in accordance with generally accepted accounting principles; (2) if the Company has not made such an identification, an explanation of why it has not done so; and (3) if the Company has made such an identification, the: (a) methodology and criteria used to make such identification; (b) number of those employees/positions, broken down by division; (c) aggregate percentage of compensation, broken down by division, paid to those employees/positions that constitutes incentive-based compensation; and (d) aggregate percentage of such

of continuing challenges in re-directing the company to avoid pressuring employees into fraudulent behavior, the voting support level for this proposal has lingered around 20%. As such, the proposal, which was refiled this year, would not have been permissible if the newly proposed rule were in effect requiring at least 25% support after the third year of voting.

Wells Fargo & Co. Shareholder Proposal on Employee Incentives and Risk of Material Loss			
Year	Vote	Existing Threshold	Proposed Threshold
2014	Excluded in SEC Staff decision		
2017	21.9	3	5
2018	21.9	6	15
2019	21.6	10	25
2020	Pending	10	**Excluded**

Resubmission of proposals at Wells Fargo has provided investors with the opportunity to prompt and focus the board and management on issues on which the company needs to keep investors updated. We see this in Wells Fargo's updates to the opposition statement accompanying the New York State Common Retirement Fund *Employee Incentives* proposal, in which, from year to year, the Company has felt compelled to provide a clear update on progress toward addressing the underlying issues. This progressively updated disclosure in the proxy statement – which otherwise may not be articulated to shareholders for consideration – offers investors significant opportunity and value to consider the continued risk of investing in the company and the ability to assess the validity of the company's remediation and risk mitigation strategies. The SEC's economic analysis and policy considerations of changes to the shareholder proposal rule, especially to the resubmissions threshold, should consider this important element of disclosure that accompanies the shareholder proposal process.

The reappearance of a proposal garnering 10% or more of support of shareholders is a prompt for company updates and disclosures on an issue of significant concern to a large portion of investors. Removing that prompt eliminates the opportunity and right of shareholders to seek such updates through the shareholder proposal process, and forces shareholders and stakeholders to resort to more costly and less efficient forms of recourse, such as litigation.

Moreover, the first such proposals filed at Wells Fargo provided early warnings of what later proved a costly crisis of company culture. Although the billions of dollars in penalties the company has paid have cut into the bottom line, even more important is the damage to the company's reputation with consumers. While Wells Fargo was once "on top of the industry in returns, valuation and reputation," observers indicate that the bank may never return to its former level of consumer confidence: "With these types of stories… the companies never get their

incentive-based compensation that is dependent on (i) short-term, and (ii) long-term performance metrics, in n each case as may be defined by Wells Fargo and with an explanation of such metrics.

premiums back … People have other places to go. Now Wells is just another big me-too bank."[16] Arguably, had Wells Fargo taken shareholder concerns on this issue to heart when shareholder proposals were first filed, the long-term damage to the company's brand and investor value could have been avoided.

Example 3. Boeing: 737 MAX Shareholder Concern on Lobbying Overreach Would Have Been Obstructed by Proposed Rules

Prior to the crashes of the 737 MAX, a portion of shareholders had long supported enhanced disclosure due to concerns about Boeing's notoriously aggressive lobbying policies and practices. Shareholder proposals beginning in 2014 sought disclosure of the company's lobbying policies, expenditures and internal controls. The proponents noted in an exempt solicitation in 2019:

> Boeing is described as "one of the US's most powerful lobbyists and "one of the biggest players in the Washington influence game." Boeing ranks as the 10th largest federal lobbying spender since 1998, spending more than $274 million… Corporate reputation is an important component of shareholder value. Boeing's reputation and financial health are at serious risk in the wake of two fatal crashes of its 737 MAX.[17]

Under the proposed rulemaking on resubmissions, the proposals would have been barred beginning in 2017, having missed the 25% third year threshold in 2016. Yet, after the 737 MAX crashes, shareholders demonstrated a new appetite for the proposal, voting 32.6% in favor in 2019. Had the proposed resubmission thresholds already been in place, shareholders at large would have been denied an opportunity to convey their concern on this issue with Boeing's management in the wake of a significant event.

The Boeing 737 MAX crashes, the death of hundreds of people, and the grounding of planes have cost the company billions of dollars in lost revenue, market capitalization, compensation to airlines and bereaved families, and lost orders. Analysis and media coverage in the aftermath of the two crashes of Boeing's 737 MAX airliners in 2018 and 2019 indicate that an underlying reason for the failure of regulators to intervene early and intercept the related safety hazards was the degree to which Boeing's lobbying practices led to regulatory capture – to such an extent that the government had largely allowed the company to regulate itself.

The Project on Government Oversight,[18] referencing detailed coverage in *The New York Times*,[19] notes:

> Citing accounts from current and former FAA employees, the New York Times

[16] https://www.ft.com/content/b858da70-1418-11e9-a581-4ff78404524e

[17] Notice of Exempt Solicitation, Seventh Generation Interfaith Inc. Available online at https://www.sec.gov/Archives/edgar/data/12927/000121465919002699/g49190px14a6g.htm.

[18] Project on Government Oversight, "Corrupted Oversight: The FAA, Boeing and the 737 MAX", October 2, 2019. https://www.pogo.org/analysis/2019/10/corrupted-oversight-the-faa-boeing-and-the-737-max/.

[19] David Gelles and Natalie Kitroeff , "Before Deadly Crashes, Boeing Pushed for Law that Undercut Oversight", New York Times, October 27, 2019. https://www.nytimes.com/2019/10/27/business/boeing-737-max-crashes.html.

> recounted… how, during the 737 MAX certification process, the agency "handed nearly complete control to Boeing" as the company was "racing to finish the plane" to compete with a rival manufacturer. As the Times further reported, FAA engineers determined after the October 2018 737 MAX crash that they did not "fully understand the automated system" that contributed to the crash, and that the regulator "had never independently assessed the risks" of the system before approving the jet the previous year.
>
> Late in the design process Boeing had made the system, known as MCAS (short for Maneuvering Characteristics Augmentation System), significantly more powerful, which introduced potential new dangers … in a move that the FAA's then-acting administrator told lawmakers during a May hearing was misguided, the FAA chose not to require Boeing to mention…In an effort to cut costs and speed the certification process, Boeing officials had pushed to reduce and downplay those differences to minimize training and testing requirements, the New York Times reported.
>
> The FAA's rules for certifying planes' safety effectively give the aviation industry the power to regulate itself—a situation bordering on legalized corruption… [raising] legitimate concerns about undue industry influence or regulatory capture—that is, when a regulator works to advance the interests of the industry it regulates, often at the expense of the public.

The New York Times reported on December 16, 2019 that Boeing will temporarily stop making the 737 MAX, its most popular passenger jet. This decision came after a two-day board meeting and represents the culmination of the worst crisis in the company's 103-year history.[20] *The New York Times* notes:

> Boeing's reputation and stock price have been battered, with shares in the company falling 25 percent since March. The company has already announced more than $8 billion in charges related to the crisis, a figure that is expected to rise significantly.

Further the *Times* notes that the decision will also affect its hundreds of suppliers around the country:

> "It will have enormous ripple effects," said Susan Houseman, director of research for the Upjohn Institute for Employment Research. "It will have very real effects on many people's lives, and it's never good for this to happen right before the holidays."

Under the proposed rulemaking, the efforts of shareholders to request better disclosure of Boeing's lobbying policies and expenditures would have been thwarted. Those proposals sought disclosure of company policy and procedures governing lobbying, both direct and indirect, and grassroots lobbying communications, information on lobbying and membership in certain trade associations, and a description of management's and the Board's decision making

[20] David Gelles and Natalie Kitroeff, "Boeing to Temporarily Shut Down 737 MAX Production", New York Times, December 16, 2019. https://www.nytimes.com/2019/12/16/business/boeing-737-max.html.

process and oversight for making payments described above. Despite the important issues raised by the proposals in encouraging effective assessment and dialogue on the distorted and harmful relationship between the company and regulatory agencies, the proposals would have been curtailed.

Boeing Shareholder Proposal on Lobbying Policy and Expenditures			
Year	Vote	Existing Threshold	Proposed Threshold
2014	22.9	3	5
2015	20.3	6	15
2016	20.6	10	25
2017	20.6	10	Excluded
2018	24.4	10	Excluded
2019	32.6	10	Excluded

The example of these prior votes at Boeing demonstrate that in some instances, while a consistent portion of shareholders remain consistently concerned about an issue – voting support may not change much until a crisis related to the issue ignites broader shareholder concern. Boeing shareholders holding 20% of its stock have voted consistently to support lobbying disclosure and represent a prescient bloc of investors. This group's persistent advocacy for better lobbying disclosure would have been shut down if the proposed resubmission thresholds were then in place.

Summary: Impact of Proposed Resubmission Thresholds

The Commission's proposal would raise the thresholds steeply to require a 5% vote the first year, 15% the second year, and 25% a third year. In addition, a new requirement would impose a "momentum" exclusion if a proposal experienced a 10% drop in voting support after the third year, even if that proposal still received nearly majority support. As demonstrated with the examples above, such rules would have excluded past proposals that ultimately succeeded in producing substantial supporting votes or company action on proxy access, diversity, climate, and other ESG issues. Had those proposals been excluded, shareholders' ability to have successful engagements would have been dramatically limited due to a lack of leverage offered by the potential proposal resubmission.

Unfortunately, Commission members seem to be undervaluing the importance of persistence by subgroups of investors with specific concerns. SEC Chairman Jay Clayton stated in a hearing of the Senate Banking Committee on December 10, 2019 that a principle underlying his support of the proposed resubmission thresholds is that, as a general rule, if one in four voting shares supports the proposal, then it can stay on the ballot.

This arbitrary choice of requiring 25% shareholder support to demonstrate a proposal's ultimate significance and relevance to investors is inconsistent with long-standing experience, in which shareholder proposals supported by substantially fewer than 25% of investors raise important ideas, support investor leadership, provide early warnings of ESG concerns and other

issues, and lead to effective company solutions and management of issues, in anticipation of the concerns and in response to the proposals. In fact, companies routinely take action after shareholder votes of less than 25%. For example, companies often change compensation arrangements if say-on-pay votes register disapproval by more than 10% of shares. Furthermore, given the nature of institutional investor voting policies and practices (which are often slow to respond to new issues) and the high percentage of stock ownership by large institutional investors, persistent support by 10% of voting shares actually represents a significant portion of shareholders.

PART II: THE COMBINED EFFECT OF PROXY ADVISORY AND RESUBMISSION PROPOSALS

Neither the proxy advisory nor the resubmission threshold rulemaking proposals include an economic analysis assessing how the economic impact of the two concurrently proposed rule changes would operate together to undermine investor voice and influence on matters of value at risk.

The rulemaking proposal amending the exemption of proxy advisors from the proxy solicitation rules would require any proxy advisory service to submit a copy of proxy voting advice that the proxy advisory firm business intends to deliver to its clients for a review by issuers, with a feedback period of no less than five business days. Inconsistent with proxy solicitation rules applicable to companies, which require public disclosure of a preliminary proxy solicitation allowing all affected stakeholders to comment to the SEC, the rulemaking proposal for proxy advisory services instead envisions a closed process between proxy advisors and issuers. It appears that the Commission has chosen, we believe arbitrarily, to avoid its responsibility to conduct a reasonable and balanced assessment of any concerns regarding misleading content that may accompany a preliminary proxy solicitation.

Allowing issuers, but not shareholder proponents, the right to review and comment on final proxy advisor recommendations prior to publication offers a one-sided opportunity for issuers and their attorneys, and fails to take account of the inherent conflict in inviting the issuer to communicate directly with the proxy advisor on areas where the proxy advisor is making recommendations contrary to management. This also circumvents the Commission's long-standing role as arbiter of concerns regarding misleading solicitations.

The effect of the proxy advisory rule is to allow issuers to threaten litigation in order to block proxy advisors' favorable recommendations on shareholder proposals. It would make it far more difficult for investors that use proxy advisors for analysis and advice to vote independently of management.

The full impact of this proposed rule on the direction of proxy advisors recommendations is ambiguous, but, as Commissioner Jackson stated in his dissent, the proposed proxy rule is

effectively a "tax" on proxy advice unfavorable to management.[21] With an unreasonably short timeframe and high stakes we can expect this rule would empower corporate secretaries and outside counsel to constrain the proxy advisors on both company proposals and shareholder proposals, disrupting and quite possibly breaking the proxy advisory system. While we don't know what portion of favorable recommendations would be lost, we know that the natural economic impact of such a tax is to diminish the taxed item.

When the proposed proxy advisory provisions are combined with the proposed steep new resubmissions thresholds, the effect will be to make it far more difficult for shareholders to persist in raising issues of material concern. It is well understood among proponents and issuers alike that many shareholder proposals achieve voting outcomes in excess of 20% only after institutional investors receive favorable recommendations on the proposals from their proxy advisors. The proxy advisors represent the effective aggregation of research and analytical resources of the institutional investment community to allow them to assess, consistent with their fiduciary duties, whether there is a strong argument for supporting a proposal, and provides many investors with necessary substantiation to make the decision to cast a favorable vote.

Because the proposed rule offers a procedural tool for issuers to effectively block proxy advisor recommendations supporting shareholder proposals, effectively a "tax" on proxy advice adverse to management positions, investors are concerned about this new form of pressure on proxy advisors to issue fewer favorable recommendations on shareholder proposals. If this occurs, voting outcomes would likely lead to fewer proposals able to surmount the steep new resubmission thresholds proposed by the Commission. Proposals that would be impeded from resubmission under the proposed thresholds, if the combined rules had been in effect previously, would logically encompass many of the prior proposals which exceeded 15 or 25% support after favorable proxy advice. Thus, the impact of the combined rules in undermining the rights and interests of investors who file or who would wish to vote in favor of those proposals – the number of proposals that would be blocked – is substantially larger than with the resubmission changes alone.

We believe it would be arbitrary and inappropriate for the Commission to adopt both rules simultaneously, as it is not possible to provide a reasonable projection of the synergistic impact of the rules on the rights of investors to protect value at risk.

[21] As Commissioner Jackson stated: "Holding executives accountable for the way they run America's corporations is difficult and expensive, and investors lack the time and money to do it. That's why investors use proxy advisors, who make recommendations about how shareholders should vote. Today's proposal imposes a tax on firms who recommend that shareholders vote in a way that executives don't like.….To see why, consider a proxy advisor deciding how to advise shareholders in a proxy fight driven by poor performance. Recommending that investors support management comes with few additional costs under today's proposal.[3] But firms recommending a vote against executives must now give their analysis to management, include executives' objections in their final report, and risk federal securities litigation over their methodology. Taxing anti-management advice in this way makes it easier for insiders to run public companies in a way that favors their own private interests over those of ordinary investors."

PART III: ASSESSING ECONOMIC IMPACT

In this section, we provide some initial documentation in response to the Commission's request for information that supports assessment of its economic analysis. According to the Commission's internal memorandum entitled "Current Guidance on Economic Analysis in SEC Rulemakings" March 16, 2012, from RSFI and OGC to staff of the Rulewriting Divisions and Offices:

> It is widely recognized that the basic elements of a good regulatory economic analysis are: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis. As a general matter, every economic analysis in SEC rulemakings should include these elements, and the following guidance addresses ways to strengthen these aspects of our economic analyses.
>
> * * *
>
> The Commission has long recognized that a rule's potential benefits and costs should be considered in making a reasoned determination that adopting a rule is in the public interest.

Unfortunately, the proposed rulemaking's analysis on *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8* (File Number S7-23-19) does not reflect this reasoned approach. To the contrary, **its economic analysis is built on inaccurate data regarding the costs of shareholder proposals, and lacks any calculation of the lost benefits that shareholder proposals and engagements bring to companies and public markets that would be impeded or terminated by these changes.**

In any final rulemaking, we recommend that economic analysis by the Staff consider the potential cost of errors of omission — the new thresholds would lead to exclusion of proposals seeking improved performance and risk oversight, as demonstrated with the examples of Chevron, Wells Fargo and Boeing, that are destined to be viewed in hindsight as indicative of risk to reputation and goodwill, of potential bankruptcies, systemic impacts and other foreseeable problems on which the proposed resubmission thresholds may have obstructed, rather than assisted, investor self-help strategies through the shareholder proposal process.

Quantitative and Qualitative Value at Risk

As demonstrated above, for purposes of SEC economic and policy analysis, the Commission must consider the multiple rights and interests affected by blocking resubmission of proposals that can later prove prescient on material issues:

- **Underlying value at risk:** Jeopardizing company value, as well as systemic risk, as the scenarios highlighted above demonstrate (climate change, consumer fraud, and lobbying overreach);

- **Investor deliberation process value:** Investors denied the opportunity to deliberate further on the issue, including the development of analysis and proxy voting guidelines to address novel or emerging concerns;

- **Disclosure value of management updates:** Investors denied the benefit of a prompt to management to publish an update on any developments in relation to the topic raised;

- **Engagement value:** There is a lost opportunity for the company to engage with key stakeholders, and to address the emerging issues in a manner that may reduce risk and increase long term value.

- **Signals to the market:** Votes taken on shareholder proposals have an impact that goes beyond the individual company at which a proposal is voted. The votes send a market-wide signal for adoption of the recommendations relevant to other companies as well.

Even if one were to accept the Commission's own estimate of a maximum of $70.6 million in costs to companies *spread across the Russell 3000 companies*[22] by reducing considered shareholder proposals by 37%[23], the loss in value to shareholders and companies regarding trillions of dollars of value at risk outweighs the saved costs by orders of magnitude. The proposed changes are not economically justifiable. In particular with regard to resubmissions, there are only minimal necessary costs of the resubmitted proposals -- the costs to the firm of physically printing the proposal on the proxy, nominal reconsideration of the proposal by board and management if that is all that the proposal merits, and updating its opposition statement to reflect any further developments on the issue. The filing of no-action requests, which are always discretionary spending by companies, tends to be reduced for resubmitted proposals as many of the potential grounds for exclusion are resolved in prior Staff decisions.[24]

Shareholder Proposals, Risk Management, ESG, and Bankruptcy Prevention

The Wells Fargo and Boeing examples demonstrate proposals that would have been excluded on matters that have taken the companies to the brink. They involve catastrophic losses which were implicated by proposals that would have, under the new rules, been excluded. The potential for ESG-type issues, such as those raised by many shareholder proposals, to flag a risk of catastrophic loss is well documented.

[22] Rulemaking proposal on shareholder proposals, table regarding Paperwork Reduction Act includes calculations for anticipated reduced proposal submissions, pages 162- 165.

[23] Rulemaking proposal on shareholder proposals, page 138, at footnote 272.

[24] For one article addressing the cost calculations see, https://www.investorrightsforum.com/new-blog-1/the-cost-to-companies-is-generally-low-and-spending-is-within-their-control.

For example, Bank of America Merrill Lynch studies have indicated that attention to ESG matters could have helped avoid or at least forewarned of as many as 90% of bankruptcies. Their analysis found that 15 out of 17 (90%) bankruptcies in the S&P 500 between 2005 and 2015 were of companies with poor scores on environmental and social issues five years prior to the bankruptcies.[25]

***

> What if we told you how to avoid stocks that go bankrupt? We think you would listen. Environmental, Social & Governance (ESG) factors are too critical to ignore, in our view. In our earlier report ESG: good companies can make good stocks, we found that ESG-based investing would have offered long-term equity investors substantial benefits in mitigating price risk, earnings risk and even existential risk for US stocks – ESG would have helped investors avoid 90% of bankruptcies in the time frame we examined.[26]

***

> Prior to our work on ESG, we found scant evidence of fundamental measures reliably predicting earnings quality. If anything, high quality stocks based on measures like Return on Equity (ROE) or earnings stability tended to deteriorate in quality, and low quality stocks tended to improve just on the principle of mean reversion. But ESG appears to isolate non-fundamental attributes that have real earnings impact: these attributes have been a better signal of future earnings volatility than any other measure we have found.[27]

The *Financial Times'* reporting on the Bank of America studies notes:

> ESG-related risks are becoming increasingly important considerations for institutional investors and asset managers because of mounting fears about climate change, high-profile scams and damaging corporate governance failures. Bank of America examined the impact on stock prices of companies in the S&P 500 index, the main US equity market benchmark, of 24 controversies related to accounting scandals, data breaches, sexual harassment cases and other ESG issues. It found these 24 ESG controversies together resulted in peak to trough market value losses of $534bn as the share prices of the companies involved sank relative to the S&P 500 over the following 12 months.[28]

The Commission's rulemaking proposal on *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8* File Number S7-23-19 has failed to assess how the proposed rule changes would undermine the functioning investment ecosystem strategies that are key to protecting trillions of dollars of value at risk. The order of magnitude of ostensible savings under the proposed rule changes is dwarfed by the value at risk. Even if the SEC's estimate that a maximum of $70.6 million that might be saved across the economy by excluding 37% of

---

[25] Bank of America Merrill Lynch, "*ESG Matters - US, 10 reasons you should care about ESG*," September 23, 2019, Corrected.

[26] Bank of America Merrill Lynch, "*Equity Strategy Focus Point, ESG Part II: a deeper dive,*" June 15, 2017.

[27] Bank of America Merrill Lynch, "*Equity Strategy Focus Point, ESG Part II: a deeper dive,*" June 15, 2017.

[28] Chris Flood, "ESG Controversies Wipe $500bn Off Value of US Companies", *The Financial Times*, December 14, 201., https://www.ft.com/content/3f1d44d9-094f-4700-989f-616e27c89599.

shareholder proposals were accurate, we believe the proposed changes would block investor responses to ***much*** greater value at risk at companies - certainly on the scale of billions or trillions of dollars - and would prevent investors from engaging effectively on major concerns.

Learning from experience: to further its investor protection mission, the Commission must avoid errors of omission

In assessing the prudence of the proposed rule changes, we believe that the Commission must consider the relationship between its mission of investor protection and the magnitude of outcomes in the event that proposals are omitted. In so doing, it must draw from prior experience in which Commission and Staff decisions have incapacitated shareholders from utilizing shareholder proposals in matters of great importance. ***Recent history has shown that SEC omission of proposals imposes far greater risk to investors than any costs associated with over-inclusion***. The economic analysis of the proposed rulemaking must take account of the risks of omitting proposals that bring investor attention where needed on proposals that may prove to be early warnings of highly material risks – both systemic and company-specific risks.

For instance, as early as 2000, shareholders recognized the risk posed by subprime lending, which later proved foundational for the mortgage crisis of the mid-2000s. The subprime lending risks taken by individual financial institutions generated concern amongst shareholders, who filed resolutions that were at times excluded by the SEC as pertaining to ordinary business. In 2000, Household International was one of the largest subprime lenders in the United States. Predatory lending in the subprime market was of growing concern to some investors as it became clear that borrowers were unable to repay these loans and were losing their homes. Subprime lending was already beginning to indicate the financial risks that would ultimately produce the housing bubble, the mortgage meltdown, and the financial crisis. There had already been bankruptcies of several large subprime lenders over the course of 1998-99.

Shareholders of Household International brought a resolution in 2000 citing interest in predatory lending amongst policymakers on the national and state level, and large settlements with lenders already being required by the FTC. The shareholder resolution filed in 2000 requested the establishment of a committee of outside directors to develop and enforce policies to ensure "that accounting methods and financial statements adequately reflect the risks of subprime lending and … employees do not engage in predatory lending practices", and issuance of a report to shareholders. In *Household International,* (March 13, 2000) the Staff determined that this proposal could be excluded as ordinary business. These shareholders who had the foresight to sound the alarm were rebuffed.

By 2007 it became clear that the problem of subprime lending posed systemic risk as subprime lending had burst the housing bubble, yet several proposals addressing the issue at *Washington Mutual* (February 5, 2008), *Merrill Lynch* (February 19, 2008; February 20, 2008), *KB Home* (January 11, 2008), and *Lehman Brothers* (February 5, 2008) were excluded after Staff

concurred with company no-action arguments. With the market in early signs of collapse, these proposals were still considered excludable by SEC staff as relating to "ordinary business." The collapse of Lehman Brothers, one of the investment banks that had received a shareholder proposal on this issue, was a uniquely catastrophic event in the crisis. Lehman's shareholders were denied their opportunity to engage with the company in 2007 *Lehman Brothers* (February 5, 2008). Lehman collapsed in September 2008.

However, in a few instances SEC staff did not concur in exclusion of shareholder proposals on subprime lending. As Paul Neuhauser, an attorney for the relevant shareholders has noted in a comment letter,[29] where proposals on subprime lending survived company challenges at the SEC:

> They never appeared on any proxy statement because the recipients in each case agreed to a change of policy with regard to predatory lending to subprime borrowers (in one case the securitizer called the proponent the day after it lost its no-action request at the SEC to request a meeting and dialogue on the matter and at the meeting agreed to alter its due diligence process with respect to loans purchased for securitization). Notably, the securitizers that received the precatory proposals and changed their practices have not been among those who have suffered during the recent unpleasantness.

Deliberative Process Takes Time and Varies by Company

Under the current rules, if a proposal does not win a baseline of support from fellow shareholders the idea is taken off the agenda for three subsequent annual meetings. The existing thresholds for resubmission of a proposal require 3%, 6% and 10% support of shareholders respectively over the first three years of submission. Examination of the case examples detailed in this letter demonstrates that the current thresholds are effective in allowing consideration of proposals over the course of years. Decisions by larger shareholders to support a proposal often only arise after a proposal has persisted long enough for slower moving, larger investment firms to establish a voting policy relevant to the specific issue raised. Thus, the resubmission thresholds of Rule 14a-8 reflect an ongoing and evolving conflict resolution process among subgroups of investors expressed through deliberation, education, proxy voting policy development, engagement, and persistence.

In some instances, early support for a proposal is limited to the firm's more knowledgeable investors on social or environmental impact – shareholders whose strategy brings their focus and attention to particular issues such as human rights or climate risk. Support for a proposal sometimes grows quickly but other times more slowly, only to be dramatically stepped up after crises like disasters or high-profile scandals. What begins as ongoing shareholder deliberation receives a significant bump in support only as the issues previously raised by a small group come home to roost.

The Commission Must Demonstrate the Need for the Proposed Rules and that the

[29] https://www.sec.gov/comments/s7-16-07/s71607-476.pdf

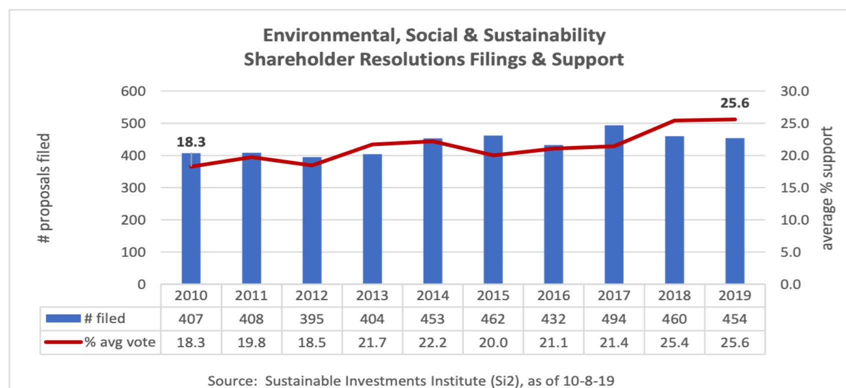
Alternative of No-Action is Inferior to the Proposals

In light of the high stakes involved in exclusion of proposals that point to impactful investor concerns, we believe the radical changes proposed to filing and resubmission thresholds, as well as the other changes in the rulemaking package, are unnecessary, unwise and inconsistent with Commission practice and guidance on economic analysis in rulemakings.

We previously asserted in comments on the docket of the Staff's Proxy Roundtable on December 4, 2018, the trends in shareholder proposals do not support a rulemaking because, in fact, the number of shareholder proposals submitted to publicly traded companies has actually declined in recent years.[30] The Staff's economic analysis accompanying the rulemaking proposals reinforces the fact that there has been no surge in shareholder proposals:

> The average number of proposals submitted to S&P 500 companies has decreased from 1.85 in 2004 to 1.24 in 2018, representing a 33 percent decrease during our sample period, and the average number of proposals submitted to Russell 3000 companies has decreased from 0.38 in 2004 to 0.28 in 2018, representing a 26 percent decrease during our sample period.[31]

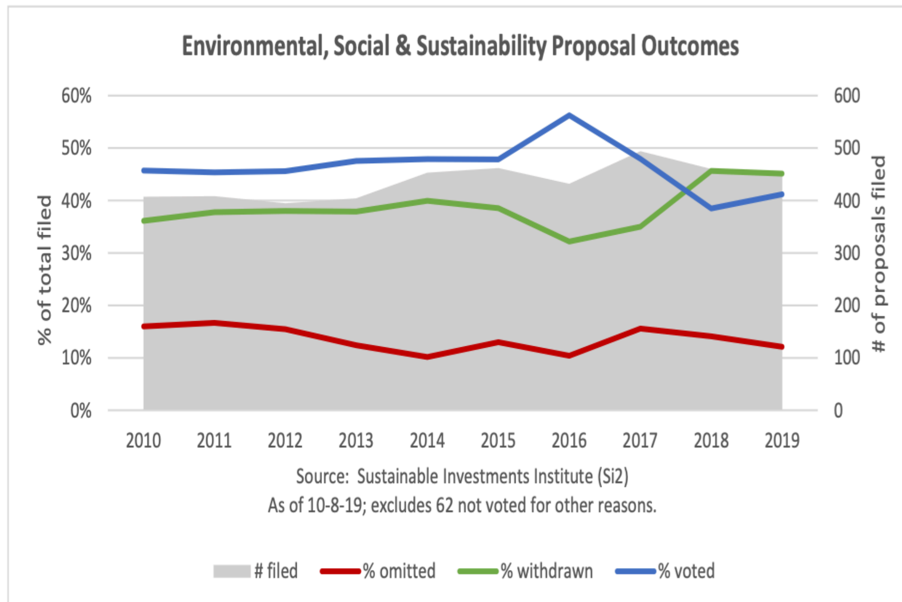
The absence of any evident surge in proposals supports taking no action on the rulemaking. Further, the proposed rulemaking seems to simply ignore the evidence that demonstrates growing investor support for ESG shareholder proposals. Taken together – that shareholder proposals are actually *declining* in prevalence and that investor interest in ESG issues in general is *increasing* – provides clear evidence that the proposed rulemaking is entirely superfluous. The following charts summarizing data from the Sustainable Investments Institute demonstrate that support for shareholder proposals on ESG issues in particular is rising. Along with voting support, companies are increasingly engaging with shareholder proponents leading to an increased proportion of withdrawals of proposals.

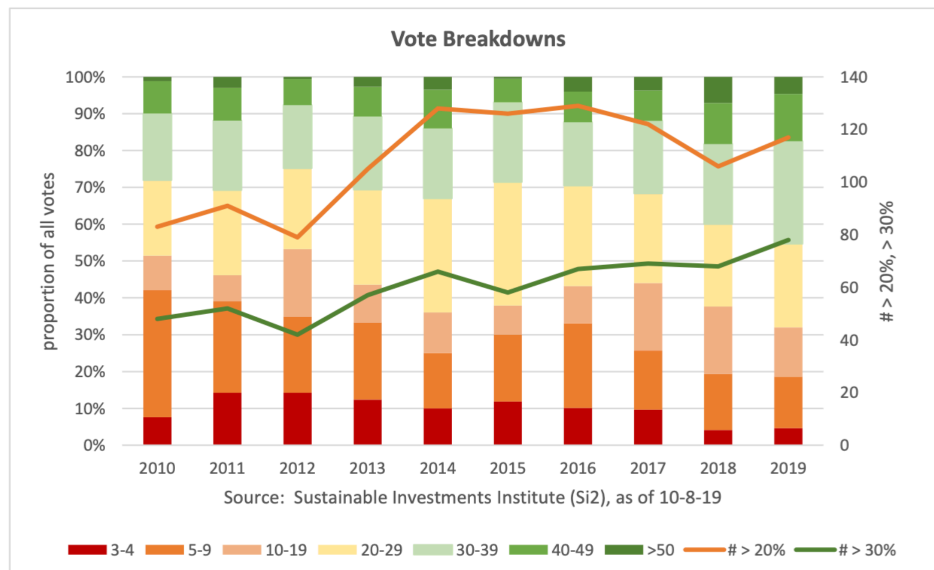


	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
# filed	407	408	395	404	453	462	432	494	460	454
% avg vote	18.3	19.8	18.5	21.7	22.2	20.0	21.1	21.4	25.4	25.6

[30] Shareholder Rights Group letter re: Staff Roundtable on the Proxy Process -- File 4-725, December 4, 2018. https://www.sec.gov/comments/4-725/4725-4722938-176724.pdf.

[31] Resubmissions rulemaking package, page 74.





The shareholder proposals that the Commission seeks to exclude have been playing a critical role in improving ESG disclosure and performance. The proposals often shed light on emerging issues not yet on the agenda of boards and management. Proposals have helped companies avoid looming liabilities or reputational harm and to capitalize on unrecognized opportunities. Many current beneficial corporate practices and corporate best practices, such as climate change strategies, pollution prevention, board gender diversity, and workplace inclusion

have been substantially initiated and shaped by shareholder proposals and resulting shareholder engagement. In the Commission's economic analysis, there is a paucity of quantification of the value of such initiatives, which would seem necessary in order to properly scale the magnitude of saved costs on any rulemaking changes against potentially lost services and benefits to society, to investors, and to their corporations provided by the proposal process.

Among the types of proposals that have proven productive in both changing the practices of individual companies receiving proposals and ultimately changing market-wide practices are proposals that sought to make independent directors constitute a majority of the board, requiring independent directors of audit compensation and nominating committees, declassification of board so that directors stand for election each year, requiring majority voting for board elections, proxy access, say on pay, encouraging companies to source deforestation-free palm oil, the adoption of international human rights principles as part of company codes of conduct, and the adoption of sexual orientation nondiscrimination policies. All of these policy changes were driven first by shareholder proposals and then by market adoption.[32]

Economic analysis by the Commission must demonstrate a need for the proposed rules, and analyze the relative impact of the alternative of *no change* to the rules.[33] It is clear to us, as proponents of many of the proposals the Commission appears to be seeking to exclude, that the alternative of *no action – no changes to the rules* – is by far an economically superior alternative to the proposed rule changes.

CONCLUSION

As a largely self-executing governance mechanism, the SEC shareholder proposal rule, Rule 14a-8, imposes minimal costs on corporations and society and promotes a degree of dynamic self-regulation by the market to provide early warnings and corrective measures on issues that might otherwise become the duty of the courts or the executive branch of government. The rulemaking proposals would undermine this dynamic governance system by blocking proposals by investors of all sizes, and especially discouraging the filing of proposals by smaller individual and institutional investors, who tend to serve as thought leaders and early responders to long-term issues and risks. Individual filers have historically, including in recent years, exercised a leadership role in developing and promoting ESG issues as well as governance initiatives, generating and protecting significant value. The rulemaking proposals undervalue the role of individual investors in thought leadership, governance, and risk management functions in the investing ecosystem and in relation to their investments.

The combined rulemaking proposals would not only undermine our rights and interests as

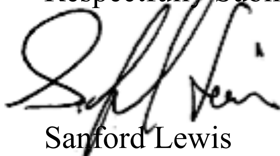
[32] "The Business Case for the Current SEC Shareholder Proposal Process", CERES, USSIF, ICCR, April 2017, pages 5-6.

[33] Former Commissioner Michael Piwowar has noted: "High-quality economic analysis helps to ensure that decisions to propose and adopt rules are informed by the best available information about a rule's likely economic consequences, and allows the Commission to meaningfully compare the proposed action with reasonable alternatives, **including the alternative of taking no action**." Commissioner Michael S. Piwowar, Remarks to the Los Angeles County Bar Association Securities Regulation Seminar, Los Angeles, California Nov. 22, 2013. https://www.sec.gov/news/speech/2013-spch112113msp#_ftnref23.

shareholder proponents; they would deprive **all** investors of the opportunity to weigh in on the proposals that they would support on governance, risk management, and corporate responsibility issues. The impact of reduced risk management, diversity, environmental responsibility, or climate change responsiveness from excluding hundreds of proposals every year would exceed the ostensible savings by many orders of magnitude in potential bankruptcies, environmental liabilities, stranded assets, reputational damage and harm to the global economy. This fact alone should be enough to block adoption of the proposed rules.

Accordingly, we urge the Commission to fully reject, and take no action on, the proposed rules.

Respectfully Submitted,



Sanford Lewis
Director
Shareholder Rights Group