



HOUSE FINANCIAL SERVICES SUBCOMMITTEE HEARING

OVERVIEW

For questions on the note below, please contact [Kwon Park](#) at (202) 547-3035.

Yesterday, the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises held a [hearing](#) entitled “Corporate Governance: Fostering a System that Promotes Capital Formation and Maximizes Shareholder Value.”

Key Takeaways

- Stuckey (Society of Governance Professionals) and Simpson (CALPERS) said the reporting requirement for institutional investors under Section 13(f) of the Securities Exchange Act for long positions (45 days) versus short positions (one day) should be updated and revised to fix the timing mismatch.
- Engler (Business Roundtable) urged the SEC to make a renewed commitment to the “materiality” standard for corporate disclosures, as public disclosures should not be an avenue to drive political and social agendas within public companies.
- Three of the witnesses advocated for raising the shareholder (SH) threshold (stock holding period of one year and \$2000 level) for submitting proxy proposals, while Simpson disagreed.

SUMMARY

Opening Statements and Testimony

Subcommittee Chairman Garrett (R-NJ)

- The federal securities laws were never intended to be a vehicle to advance unrelated social and public policy goals (i.e. conflict mineral rule).
- The current SH proposal process, corporate governance provisions of Dodd-Frank, and disclosure effectiveness proposals need change/ reforms.

Subcommittee Ranking Member Maloney (D-NY)

- Corporate governance issues impact everyday public companies, and investors need ownership rights in these companies. Companies and the SEC err on the side of including SH proposals – after all, SHs are owners of the company.
- The SEC can do much more to encourage SH participation in the proxy process and should undertake review of the ordinary business exclusion to make it more SH friendly.

- The universal proxy voting system should allow SHs to vote for directors, management selected or proponent’s nominees, wherever they vote (either in-person or via proxy). We hope SEC staff will make their recommendation to the Commission soon.

Sherman (D-CA)

- The system is rigged in favor of CEOs and nothing is in the interest of SHs.

The Honorable John Engler, President, Business Roundtable

- The Financial CHOICE Act is a serious effort to reform Dodd-Frank, which has been detrimental to business growth.
- The public company disclosure rule needs a renewed commitment to the “materiality” standard. Required disclosures should only provide investors with essential information required for proxy voting decisions. Disclosure systems should not address social and environmental issues – this results in complexity and information overload.
- The current SH proxy proposal process is outdated and is being abused. It places significant costs on companies and limits company resources that can be better utilized on long-term goals. Social and political agendas are unrelated to SH interests as a whole. The low thresholds for submitting proxy proposals are driving the negative trend to further social and political agendas.

James R. Copland, Senior Fellow and Director of Legal Policy, Manhattan Institute

- The SH proposal process is ripe for reform. Small groups of investors repeatedly file the same proposals across a broad range of companies that are not related to SH value. The ultimate task of SH proposals should be based on increasing SH value.

Anne Simpson, Investment Director, California Public Employees’ Retirement System

- Executive compensation should be fully disclosed and interests should be aligned between management and investors. We support say-on-pay, clawbacks, and pay-ratio disclosure rules.
- The Section 14(a)(8) proxy rule is a good example of engaged owners bringing informed changes to the market.
- Investors should determine the range and scope of what is “material” on corporate disclosures. The current Regulation SK disclosure regime is helpful. There is great potential in technology for modernizing reporting standards. Funding is vital for the SEC to do its job.

Darla C. Stuckey, President and CEO, Society of Governance Professionals

- The need to use corporate proxy statements to bring about social change is now moot with the internet and technology.
- Section 14(a)(8) proxy rule fosters communication between corporations and SHs, but thresholds should be increased to limit a small number of SHs from burdening other SHs. The resubmission threshold is the mechanism for protection, and the SEC should raise these thresholds.

- The proxy proposal process is being abused by non-SHs – the right to submit a proposal should not be assignable, as according to law.
- The SEC staff's interpretation of the proxy rule ignores exclusion provision requiring that proposals impact 5% of a company's business.
- The SEC is the agency responsible for public company disclosure, and those who claim to be the standard setters should not write the rules. The "materiality" standard is based on facts and circumstances of a company, and not everything that is important to SHs needs to be in a company's public disclosures.

Discussion

Securities Exchange Act 13(f) Reporting

Scott (D-GA): As proposed today, Section 13(f) of the Securities Exchange Act would require institutional investors to report their long positions within 45 days each quarter. Dodd-Frank gave the SEC authority to require short position reporting once every month. There is a timing mismatch here – what is the impact of disclosure inconsistency on markets? *Stuckey:* These rules are outdated. Due to technological advances, long position submissions can be produced in one day instead of 45 days. Short positions are currently only disclosed by exchanges. Long position disclosures need to be shortened and the short position reporting should be matched (timing). Corporate directors and officers have 2 days (4 days for corporate interests), activist hedge funds have 4 days, and investment managers have 45 days to disclose long positions – this does not seem fair. The SEC can act as there are two petitions for rulemaking; *Simpson:* The rule is completely outdated. The industry should make better use of technology and ensure that the disclosure regime favors a company's long-term goals. Short-term, activist trading is detracting from companies' long-term goals. The SEC needs additional resources to complete this Dodd-Frank mandate.

"Materiality" Disclosures

Garrett: What are the consequences of expanding the definition of "materiality" to include sustainability, climate change, and other social/political agendas? *Engler:* Proxy statements will be overloaded with too much information and will lose their significance. Companies have the ability to address sustainability and other social issues on voluntary reports; *Copland:* The one-year threshold and \$2,000 to submit a proxy proposal are too low; *Stuckey:* The threshold for resubmission rights should be raised.

Royce (R-NY): In relation to the no-action decision that was overturned by the SEC (i.e. Whole Foods decision) - how has growing failure to dismiss immaterial disclosures impacted SHs? *Engler:* The SEC has the rulemaking authority to address this problem. Punting the issue has created more problems.

Proxy Access and Proposals

Maloney: Discuss CALPERS' efforts on proxy access since 2011. *Simpson:* We believe that the element of good governance is associated with good performance. It is important to use 14(a)(8) in major companies to introduce proxy access – this minority view has now turned into the majority view.

Sherman: The SEC's job is to protect investors, even against things that involve social and political issues. Are you advocating that a SH hold a stock for more than one year to make a proxy proposal when people get favorable tax treatment for holding stocks for a shorter period? *Engler*: Yes, I would make the holding period longer.

Hultgren (R-IL) and Royce (R-NY): What are the costs imposed on companies due to the current proxy proposal process? Is the one year holding period sufficient? How many SH proposals were submitted that did not provide investors any benefits? *Engler*: Substantial costs are imposed, and more from resubmissions. The holding period is clearly inadequate and should be longer than one year; *Stuckey*: Direct costs on SH proposals are approximately \$900 million a year; *Copland*: Social and political SH proposals were about half of all proposals this year, and they negatively impact SH value.

Schweikert (R-AZ): How do you avoid conflicts of societal passions being driven by the investment committee? *Simpson*: CALPERS abides by the fiduciary duty provision under the California Constitution that cannot be overridden.

Proxy Advisory Firms

Hill (R-AR): What are your views on conflicts of interests of proxy advisory firms and the companies that hire them? *Engler*: Conflicts exist; *Simpson*: CALPERS does not rely on advisory firms for investment decisions and engages companies directly as a primary source of information; *Copland*: ISS has a tough job – the problem is misalignment of what ISS does and what the median SH wants. ISS has a significant impact on proxy votes and acts effectively as a 15% voter of all Fortune 250 companies.

Conflict Minerals

Huizenga (R-MI): What are the direct costs incurred from the rule? *Engler*: Companies completely avoid sourcing in that region, and the supply chain is moving off the African continent due to the compliance risks; *Stuckey*: Cost of compliance is estimated at \$710 million.

Clawback Provision

Ellison (D-MN): How do we promote good corporate governance – does CALPERS support Dodd-Frank's clawback provision? *Simpson*: Yes.

Say-On-Pay

Ellison (D-MN): Views on the say-on-pay provision? *Simpson*: The say-on-pay provision will be beneficial to investors.

Board Diversity

Maloney: What is the importance of board diversity from an investor's perspective? *Simpson*: Research shows that diversity is good for risk management (challenges group think) and talent recruitment.