



The Global CEO Advisory Firm

Teneo Insights

SEC Votes to Issue Proposed Rules Addressing Shareholder Proposals and Proxy Advisors

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On November 5, 2019, the Securities and Exchange Commission voted 3-2 along party lines to issue proposed rules governing the submission and resubmission of shareholder proposals for inclusion in company proxy statements and establishing new regulations for proxy advisory firms. The proposed rules include a wish list of changes long requested by the business lobby. If approved in whole or in part, the proposed rules would have important ramifications for shareholders, proxy advisory firms, and public companies.

New Restrictions on Shareholder Proponents

The proposed changes to the shareholder proposal rule would increase ownership/holding requirements from \$2,000 of company stock (or 1% of outstanding securities) for one year to a sliding scale of ownership: \$25,000 for one year, \$15,000 for two years, and \$2,000 for three years. It would also update the “one proposal” rule to apply to a “person” rather than a “shareholder;” in effect, the change would prohibit a single person from submitting a proposal in one’s own name and as a representative of another shareholder at a shareholder meeting. Further, the levels of shareholder support a proposal must receive to be resubmitted at a future shareholder

meeting would increase from 3%, 6%, and 10% for topics voted on once, twice or three times in the last five years to 5%, 15% and 25%, respectively. The rule would also require shareholder proponents to be available to engage with the targets of their proposals after submitting their proposals.

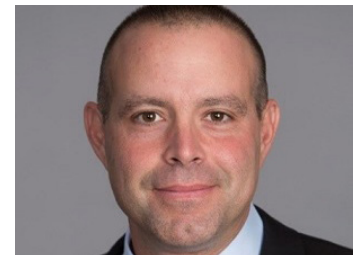
The proposed changes could reduce the number of shareholder proposals at shareholder meetings of U.S. companies. The new ownership thresholds could limit the ability of investors – particularly retail investors – to promote their agendas through the shareholder proposal process. In addition, the rules would likely limit the influence of retail investors who collaborate in the sponsorship and presentation of a disproportionate number of the shareholder proposals filed at large U.S. companies. In theory, requiring shareholder proponents to engage with the targets of their proposals could facilitate negotiated withdrawals, though a significant number of proposals already are withdrawn after proponent/ issuer engagement. The changes are not without risk to companies, however: limiting investors’ ability to opine on a topic via the shareholder proposal process could lead investors to vent their frustrations on board candidates in greater numbers, especially considering the SEC’s revised no-action process.



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Reining in Proxy Advisors

The proposed rules would amend proxy solicitation rules to impose new regulations for proxy advisors such as ISS and Glass Lewis. Notably, companies that are the subjects of proxy advisor research would have the right to review and provide feedback on pre-publication reports and recommendations, a right currently offered only by ISS to S&P 500 companies. Companies would have between three and five business days to complete the initial review and provide feedback, depending on how far in advance they file their proxies; currently ISS provides draft report receivers with only a 24-48-hour window to provide feedback. Companies would also have the right to review a final version of the report no later than two days prior to dissemination to proxy advisors' clients and elect to require the proxy advisor to include a hyperlink directing investor clients to a written statement setting forth the company's view on the report. The amendments would also require proxy advisors to disclose material conflicts of interest, which will be defined by the SEC.

The proposed changes would allow more companies to review proxy advisors' reports prior to publication to highlight errors and/or material omissions and expand the window during which they could do so. Whereas proxy advisors currently have the last word on the content of their reports, the changes would provide companies the opportunity to include a hyperlink to a document containing commentary or rebuttal arguments in a proxy advisor's final report. If approved, the rule could have other consequences. Since the proposed changes would add to proxy advisors' proxy season workload, ISS and Glass Lewis could expand efforts to front-run their research

process. For ISS, this could include providing companies with opportunities to review and verify data in advance of shareholder meetings, similar to Glass Lewis's current offering. Both proxy advisors could expand their engagement efforts outside of proxy season to minimize the likelihood of in-season disagreements. In addition, if the rule changes result in a significant delay in the delivery of ISS research to its investors, then they may have less time to engage with companies.

ISS Hits Back

On October 31, 2019, ISS filed suit against the SEC, seeking relief from the Commission's guidance of August 21, 2019 ([see Teneo Insights, August 2019](#)). According to ISS CEO Gary Retelny, "We believe litigation to be necessary to prevent the chill of proxy advisers' protected speech and to ensure the timeliness and independence of the advice that shareholders rely on to make decisions with regards to the governance of their publicly traded portfolio companies." Suing one's regulator is an unusual step and one wonders if ISS (or Glass Lewis) will continue to seek to forestall the SEC's effort to regulate them through the court system.

Next Steps

Companies and investors are sharply divided on the proposed rules. National Association of Manufacturers President and CEO Jay Timmons noted that, "Reforming the proxy process will empower manufacturers to invest in our people and our communities more confidently—and to power economic growth for all Americans." According to Ken Bertsch, Executive Director of The Council

for Institutional Investors (CII), “The rules are an unnecessary interference in the free market, and would impede investors’ voice on critical matters at U.S. public companies.” Public comment on the proposed rules will be open for 60 days following publication of the proposing release in the Federal Register. Given the level of interest, businesses and investors – individually and through membership organizations – are expected to submit comments.

In the meantime, companies should take advantage of the fall and winter months to engage with proxy advisors if they have questions or concerns with their 2019 report or anticipate potential concerns at their 2020 annual meetings. Additionally, companies should continue to participate in ISS’ draft review process if they are eligible to do so, and all companies should request a complimentary copy of their report from ISS.



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