

Coalition Of Trade Associations Urges Congress, SEC To Update Proxy Rules

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A coalition of five trade associations Nov. 6 announced their campaign to push Congress and the Securities and Exchange Commission for a review of the rules that govern shareholder voting and ownership at public companies.

In a release, the Shareholder Communications Coalition assessed current proxy and disclosure rules under the federal securities laws as “antiquated,” saying they do not enable companies to easily discover the identity of their beneficial owners.

To reform the system, SCC urged the SEC to enable companies to access the contact information of all their beneficial owners; shareholders that insist on anonymity should bear any related costs, it said. The SEC should further seek to protect voting by retail investors, and to oversee proxy advisory services.

SCC's campaign is timely, given that a new Congress, administration, and SEC chairman will take office in January. John Castellani, president of the Business Roundtable—one of SCC's five members—said “We look forward to working with Congress and the SEC to address these problems as part of a broader review of how best to regulate financial markets in the future.” SCC's other members are the National Association of Corporate Directors, the National Investor Relations Institute, the Securities Transfer Association, and the Society of Corporate Secretaries and Governance Professionals.

Empty Voting.

Suggesting that voting and disclosure rules have not kept pace with financial innovation, SCC pointed to “abusive” practices in share lending programs, and complex derivative products, that are undermining the current system. Lending agreements often assign voting rights to borrowers, not owners, of shares. As a result, the voter may have little or no economic interest in the company. This phenomenon—called “empty voting”—particularly arises when investors indirectly own corporate shares through swap or other derivative contracts.

SCC's call for the SEC to address the prevalence of voting decoupled from ownership is not new. Academics and attorneys alike have similarly urged the regulator to act on the matter (158 DER A-22, 8/15/08). Indeed, empty voting gained attention particularly after the publication of an article by Henry T. C. Hu and Bernard S. Black—finance professors at the University of Texas Law School. Hu and Black advocated revising the beneficial ownership reporting requirements under the 1934 Securities Exchange Act to mandate disclosure of arrangements that facilitate empty voting.

In August, SEC Chairman Christopher Cox told BNA, after a news conference on an unrelated matter, that the new five-member commission was “very interested” in tackling that and related issues in the upcoming in weeks and months (162 DER A-5, 8/21/08). The SEC's leadership, however, looks set to change once President-elect Obama and his new administration assume office in January.

Institutional Versus Retail Voting.

Under Cox's leadership, the agency has taken strides in the area of proxy voting. For instance, the SEC in June 2007 changed its proxy rules under the 1934 Securities Exchange Act to require issuers and other soliciting persons to post their proxy materials on an Internet site and provide shareholders with notice that the materials are available (119 DER A-31, 6/21/07). Prior to his departure from the SEC, former commissioner Paul Atkins suggested voting among retail shareholders since so-called e-proxy has declined (141 DER A-21, 7/23/08).

Although SCC did not link e-proxy to this voting passivity, it urged the SEC to protect unvoted retail shares. Due to their legal and other responsibilities, institutional investors tend to vote all the time, SCC said. They also hire proxy advisors for assistance. By contrast, retail investors tend to lack the motivation to vote. To protect retail investors' interests, the SEC should permit proportional and client-directed voting.

The SEC considered both mechanisms at a 2007 roundtable on proxy matters (102 DER A-26, 5/29/07). At the same roundtable, it also recognized low retail vote turnout.

Regarding the use of proxy advisors, SCC complained that they are not subject to disclosure requirements or oversight, though they “are able to wield enormous influence in corporate elections.” Moreover, proxy advisors that also provide companies with consulting services—such as governance ratings, advice, and research—have inherent conflicts of interest in the voting process. SCC asked the SEC to review the role of proxy advisors and the procedures underlying their recommendations.