SPEECH

Remarks at the 10th Annual Transatlantic Corporate Governance Dialogue

Chair Mary Jo White

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I am honored to open this program and welcome you to Washington and the Securities and Exchange Commission. An exceptionally distinguished group of speakers and panelists have gathered to participate in this year's conference and I am sure the discussions will be lively and very productive. I would like to extend a special welcome to Minister Counselor Simonas Šatūnas, representing the European Union Presidency, and Ugo Bassi, representing the European Commission.

Your agenda is full – you have expert speakers and very informative panels addressing shareholder activism, proxy advisory firms and the say-on-pay experience – topics of great interest to all of us. There also will be a focus on the role that should be demanded of the institutional investor, the activist investor and the proxy advisory firm in the governance of a company. I look forward to hearing the ideas that emerge today on these and on all of the other topics you discuss.

Over the years, shareholders have become increasingly engaged with the companies in which they invest in order to influence boards and management.[1] Much of this increased engagement can be traced to campaigns that used shareholder proposals to address corporate governance practices that were viewed as entrenching management and preventing growth, such as supermajority voting, classified boards and anti-takeover devices.

Your program will inevitably discuss the differing forms of engagement that occur today and use terms like "active ownership" and "shareholder activism" and refer to some players as "shareholder activists." But regardless of the labels, all of these terms describe what are, in essence, efforts of investors to influence a company's decision-making.

It was not a long ago that the "activist" moniker had a distinctly negative connotation. It was a term equated with the generally frowned-upon practice of taking an ownership position to influence a company for short-term gain. But that view of shareholder activists, which has its roots in the raiders of the 1980s takeover battles, is not necessarily the current view and it is certainly not the only view.

The nature of the practices and objectives associated with shareholder engagement is changing. More and more, investors have become comfortable with being called an "activist" in part because of the support they have received for their goals and, in some cases, even the tactics that they use. As we meet here today, there is widespread acceptance of many of the policy changes that so-called "activists" are seeking to effect.

To be sure, some critics still say that activists are often motivated by short-termism, and not focused on long-term growth and the strength of a company.[2] The landscape has unquestionably changed.

And shareholders now have new tools to assist their efforts. Say-on-pay advisory votes required by the Dodd-Frank Act provide a direct path for investors to comment on executive pay;[3] changes to the SEC's proxy rules on shareholder proposals provide a mechanism to continue the discussion on proxy access;[4] and the role of proxy advisory firms makes it increasingly difficult for companies to avoid addressing shareholder proposals that result in a vote that is unfavorable to management's position, even when the vote is not binding.[5] With the passage of the Dodd-Frank Act came other new rulemaking mandates for the SEC: to provide shareholders with new standards for compensation committees;[6] new compensation "clawback" policies;[7] and new disclosure requirements on executive pay,[8] chief executive to employee pay ratios,[9] and hedging by directors and employees.[10] These changes were supported by so-called shareholder activist groups in pursuit of more influence on corporate governance.

During this program, you will no doubt discuss the appropriate and optimal practices to deal with engaged shareholders, whether you call them activists or not. And while there will inevitably be differences of opinion, I think most would agree that the advice on how to respond to shareholder engagement today is quite different from the advice companies were getting 30 years ago or even 10 years ago. The process has become less defensive and more proactive. We are seeing a concerted effort to persuade shareholders of the wisdom of management's choices and practices. That is a good thing.

You also will consider whether this new era of activism is actually leading to better governance practices and to increases in shareholder value. These are all important questions to discuss and address, and I am looking forward to hearing your views.

Shareholders' Role

All of these questions and developments are important because shareholders have a critical role to play in corporate governance. When shareholders have the ability to scrutinize a company's corporate governance practices, they can help to identify areas of improvement. But, this only happens if the board and management invite shareholder engagement and actively consider the interests of the shareholders they serve. Even in companies with so-called state of the art corporate governance practices, engagement with shareholders provides very valuable feedback and insights.

Engagement with shareholders should mean more than just mailing out the annual proxy statement and conducting the annual meeting. It should mean proactive outreach, and clear, direct, and honest communications about how and why decisions are being made. Companies must work to inform their shareholders, to convey information about their governance policies and practices and to convince shareholders to vote, on the merits, for the company's nominees for director and for management's proposals. And the board of directors is – or ought to be – a central player in shareholder engagement.

Take say-on-pay votes. These votes, which were mandated under Dodd-Frank, have driven increased engagement and communication about a company's executive compensation. The board must approve these decisions. But what role do the shareholders have? In the United States, say-on-pay votes are advisory votes. Advisory votes are just that – advisory. The votes are technically not binding on companies, and shareholders have generally not been successful in suits challenging boards that ignore a "no" vote. But the public relations reaction and the potential impact on future director elections make ignoring a "no" vote harder and much more complicated than just pointing to the advisory nature of the statement by shareholders and winning a legal skirmish in state court.

Of course, companies would like to avoid a "no" vote on pay practices and they are using their executive compensation disclosures to make their case. Through these disclosures, which include not only what an executive was paid, but also why the company thinks that the executive should be paid that much, companies are working harder to more fully explain the rationale and considerations for its decisions on pay. And shareholders have the opportunity to communicate how they feel about the company's pay practices, by either voting for or against the approval of the executives' compensation.

In most cases, companies receive favorable votes. According to one report, over 3,100 companies held say-on-pay votes in 2013, and as of mid-November, only 69 of these companies had failed to obtain approval.[11] In addition, 71 percent of the companies that received a favorable vote received greater than 90 percent support.[12]

If a company's say-on-pay proposal does not achieve the desired level of support, management may want to engage with shareholders to get specific feedback on the components of the company's compensation policies and programs. The transparency and engagement we are seeing in the area of executive compensation is wise and provides a real voice for shareholders that companies are paying attention to.

This is just one example, but it shows how boards and management engage in direct and effective ways on issues of importance to investors.

Of course, there are other examples of company and shareholder engagement. Historically, shareholders have engaged with their companies on a variety of corporate governance issues – independent directors, majority voting, executive pay, and many others. And they have done so through a variety of avenues. One such method is the shareholder proposal.

Under the SEC's proxy rules, a shareholder with a relatively small investment in a company's securities has the opportunity to have his or her proposal included in the proxy materials for an annual meeting right beside management's proposals.[13] The shareholder proposal rule provides a cost-effective and powerful avenue for shareholders to communicate with companies they invest in, and, importantly also, with fellow shareholders.

In the 2013 proxy season, for example, according to one source, shareholders submitted over 850 proposals for 2013 shareholder meetings.[14] The most common 2013 shareholder proposal topics were board declassification, appointment of an independent board chair, limitations on accelerated vesting of equity awards, disclosure of political contributions and lobbying, and sustainability reporting.[15]

In many cases, companies do not resist shareholder proposals, but simply include them in their proxy materials, or negotiate with the shareholder submitting the proposal to come up with a mutually agreed upon approach to an issue and the shareholder withdraws the proposal. In still other cases, companies are engaging with shareholders that have indicated an interest in a topic even before the shareholder has submitted a proposal.

Engagement using shareholder proposals has occurred for many decades and continues today, and it certainly can influence companies' practices.

This has been the case, for example, with shareholder proposals on majority voting standards for director elections. These proposals have been frequent, particularly in the past ten years, and in many cases, companies have decided to adopt such standards.[16] This is not to say that companies can or should always do exactly what every shareholder asks of them, but it is important that the board and management listen to what their shareholders have to say and adjust their governance practices when warranted.

The Role of Proxy Advisory Firms

You will be spending some time over the course of your program talking about the appropriate role of proxy advisory firms – a current topic of considerable interest in the United States. Proxy advisory firms play a role in corporate governance and shareholder engagement in a variety of ways. In addition to assisting institutional investors in analyzing and making voting recommendations, proxy advisors also may provide research and identify potential risk factors related to corporate governance. And they may provide consulting services to issuers on corporate governance matters, or rate companies' governance structures, policies, and practices.

Proxy advisory firms are seen by some as enhancing shareholder engagement because they assist shareholders or the investment advisers acting on their behalf in developing a better understanding of what a company is doing or wants to do. Others assert that proxy advisory firms are impeding true shareholder engagement by providing their views on governance matters, which a shareholder may too easily accept without undertaking an independent assessment. This perspective argues that proxy advisory firms have too much influence on establishing corporate governance practices in the United States, and that this influence has come at the cost of true engagement between companies and shareholders. Others have a decidedly different view.

As you know, in 2010 the Commission issued a concept release on the proxy voting system.[17] As part of that concept release, the Commission sought public comment about the use of services provided by proxy advisory firms, transparency and accuracy, and potential conflicts of interest. We received numerous comments in response and various suggestions for new regulations and other changes. Our analysis of these questions at the SEC continues.

Your discussion today will focus on the European experience with special attention on the report issued earlier this year by the European Securities Market Authority on the role of the proxy advisory industry as service providers to institutional investors who invest in European listed companies.[18] ESMA, interestingly, determined that a regulatory response was not warranted, but noted that increased transparency could foster greater understanding among stakeholders. And so it recommended that proxy advisory firms adopt a code of conduct that would encourage transparency with respect to disclosing and managing conflicts of interest and to foster greater accuracy and reliability of advisory firm recommendations. I will be very interested in your thoughts about the European experience and your assessment of the ESMA report and its recommendations.

As many of you know, this week on Thursday, the SEC staff will host a public roundtable to discuss the services provided by proxy advisory firms.[19] We will have excellent panelists who represent a cross-section of the various constituencies. And we too will focus on the role and influence that proxy advisory firms wield in the process, identifying what the problems are, and whether further market or regulatory responses are needed and, if so, what the responses should be. The discussions you have today will directly inform the Commission and staff as we host our own roundtable. We thank you for your timely input.

Conclusion

Let me close these welcoming remarks by thanking you again for assembling and attending this important dialogue. We have much to learn from each other about corporate governance. It is a dynamic, evolving process and one well worth the attention, hard work and critical analysis that it is being given to it by shareholders, companies and the regulatory community.

Thank you.

[1] Marc Goldstein, "The State of Engagement between U.S. Corporations and Shareholders," a study conducted by Institutional Shareholder Services for The Investor Responsibility Research Center Institute, 2011, *available at* http://www.issgovernance.com/files/private/IRRC-ISS_EngagementStudy.pdf

[2] *See, e.g.*, Martin Lipton, "Empiricism and Experience; Activism and Short-Termism; the Real World of Business," *available at* http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.22901.13.pdf .

[3] *See* Exchange Act Rule 14a-21 [17 CFR 240.14a-21].

[4] *See* Exchange Act Rule 14a-8(i)(8) [17 CFR 240.14a-8(i)(8)] and Facilitating Shareholder Director Nominations, Release No. 33-9136 (August 25, 2010).

[5] ISS recently published updates to the U.S. Corporate Governance Policy for 2014 and updated its recommendation for voting on director nominees in uncontested elections in circumstances where the board failed to act on a shareholder proposal that received majority support in the prior year. *See* http://www.issgovernance.com/files/2014USPolicyUpdates.pdf .

[6] Section 952 of the Dodd Frank Act.

[7] Section 954 of the Dodd-Frank Act.

[8] Section 953(a) of the Dodd-Frank Act.

[9] Section 953(b) of the Dodd-Frank Act.

[10] Section 955 of the Dodd-Frank Act.

[11] *See* Steven Hall & Partners, Short Takes, *available at* http://www.shallpartners.com/our-thinking/short-takes/2013-say-on-pay-voting-results/ .

[12] *See id*.

[13] *See* Exchange Act Rule 14a-8 [17 CFR 240.14a-8].

[14] *See* Ernst & Young, Key Developments of the 2013 Proxy Season (June 2013), *available at* http://www.ey.com/Publication/vwLUAssets/Key_developments_of_the_2013_proxy_season/$FILE/Key-developments-of-the-2013-proxy-season.pdf .

[15] *See id*. and Ernst & Young, Proxy season 2013 preview, *available at* http://www.ey.com/Publication/vwLUAssets/2013_Proxy_season_preview/$FILE/Proxy_Season_Preview_2013.pdf .

[16] According to one report, more than three-quarters of S&P 500 companies have some form of majority voting in director elections. *See* ISS Governance Weekly (September 20, 2013), *available at* http://hosted-p0.vresp.com/305059/d5c68f4e0a/ARCHIVE .

[17] *See* Concept Release on the U.S. Proxy System, Release No. 34-62495 (July 14, 2010), *available at* http://www.sec.gov/rules/concept/2010/34-62495.pdf.

[18] *See* Final Report, Feedback statement on the consultation regarding the role of the proxy advisory industry (February 19, 2013).

[19] *See* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540266939#.UpvH5uKPyYU and http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540419621#.UpvIAOKPyYU.

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