Remarks at the Transatlantic Corporate Governance Dialogue

by

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Good morning, welcome to the Securities and Exchange Commission.

It is a pleasure to see so many individuals, from such diverse backgrounds and so many nations coming together in Washington for a dialogue on issues that will affect economies on both sides of the Atlantic.

In a world where most observers are focused on broad macroeconomic indicators — interest rates, retail sales, movements in the financial markets and so on — corporate governance often gets short shrift.

But the cumulative effect of uncounted governance decisions can be tremendously important. Are boards — and the corporate officers who report to them — focused long-term gains or short-term goals? Are systems in place to allow effective communication between investors and the management and boards of the companies in which they share an interest? Do shareholders have effective mechanisms to ensure that their voices are heard and their opinions are considered? Do boards respond in a thoughtful and comprehensive manner? And is the disclosure that companies provide to shareholders and potential investors sufficient — especially in terms of risk management?

In short, are shareholders and boards, along with management, sufficiently engaged to ensure a quality of corporate governance commensurate with the demands of managing a public company?

When the answer to this question is, “yes,” we believe that economies broadly benefit as well-run companies flourish and grow, and that investors in particular benefit from quality information and insight into management’s priorities, allowing investors to balance risks and to allocate their capital accordingly.

Effective engagement is a strong positive. But, in attempting to foster effective engagement we face a challenge: the definition of “effective engagement” is imprecise. In fact, the definition of effective engagement can vary significantly from company to company, as investors and boards interact in very different ways, but achieve similarly positive financial results and equally satisfying relationships between shareholders and boards.

There is no exact formula. I do, believe, however, that engagement lies at the crossroads of communication and responsiveness. And that, as a regulator, my goal should be not to detail the type of communication or the level of responsiveness, but to put in place structures that encourage governance practices characterized by these attributes.

Accurate disclosure of material financial information is, of course, a first principle of this type of regulation. And here, we do not shy away from detailed disclosure requirements.

But engagement is more than disclosure. Shareholders should have a voice and a straightforward and transparent process for engaging with companies on issues that are important to them. Shareholders and boards should have clear conversations about how the company is governed — and why and how decisions are made. As a general rule, interested, aware and active shareholders are good for public companies, and I believe that more shareholder engagement is better.

But here, detailed prescriptions are more difficult to write.

And so, as regulators, we do not see our role as quantifying "appropriate" levels of engagement or laying out precise steps to reaching it. The SEC is not interested in determining the communications strategies of individual companies.

What we are interested in is breaking down barriers that may prevent effective engagement, impact investor confidence and, ultimately, diminish financial performance to the detriment of shareholders.

As a regulator and as a former board member, I believe that it is vital that shareholders and board members become more engaged in the shared pursuit of high quality governance. And, as Chairman of the U.S. Securities and Exchange Commission, I have made crafting a regulatory framework that facilitates effective engagement a priority.

As you already know, we are moving toward a framework in which investors have better information, qualitatively and quantitatively, and more effective ways of expressing their reaction to the information that is disclosed.

Background

The SEC's role is different from those of securities regulators in other countries. While we sit at the center of the U.S. economy's financial regulatory process, we are just one of several agencies concerned with financial regulation, and there a both overlaps and gaps in the collective oversight responsibility.

There is also a parallel system of state financial regulators with whom we often work, and there is state corporate law, which actually is the foundation for most corporate governance decision-making in the United States.

In addition, Congress zealously guards its oversight responsibilities. Our mandate can be expanded or restricted by statute, and often is.

And the court system often has the final word on SEC regulations, as well.

Within the Commission itself, the Commissioners represent both major political parties and, thus, differing regulatory philosophies. But, our view is that give-and-take among Commissioners, and consideration of differing views produces rules that are well-thought-out and more effective in practice.

As you can see, the SEC is subject to a number of checks and balances. And so our regulatory agenda is anchored both in our investor protection mission — which includes effective investor engagement — and a deep respect for what Bismarck called “the art of the possible.”

Disclosure

As I mentioned, communication is the first pillar of effective engagement. For this reason, one of the first regulatory changes we made when I became Chairman was to increase disclosure about the qualifications of directors and director nominees; compensation consultants’ fees and conflicts of interest; and about the relationship between a company's overall compensation policies and its risk profile.

The new rules required more than a bare outline of a board candidate’s qualifications; the rules also require the “specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director…in light of the [company’s] business and structure.”

Proxy statements now contain — in most cases — a thorough discussion of the risk-related responsibilities of the board and its various committees, as well. This can include a detailed narrative regarding the company’s reporting to the board and its committees about credit and liquidity risks, risk-focused auditing strategies, and the impact on risk of compensation policies.

While not all companies are as forthcoming in the areas as we would like, investors are, on the whole, receiving substantially better communications in areas that proxy statements once glossed over.

Proxy Plumbing

The SEC is also examining ways to promote greater efficiency and transparency in the U.S. proxy system itself, including enhancing the integrity of the shareholder vote. In July, 2010, for the first time in 30 years, the SEC initiated a thorough review of the U.S. proxy system by publishing a concept release.

Every year, over 600 billion shares are voted at more than 13,000 shareholder meetings. Our concept release elicited 275 comments on key aspects of this process, including:

Whether our rules should be revised to improve communications between shareholders and corporations and to encourage greater participation by shareholders in the voting process, and whether voting power is aligned with economic interest and whether our disclosure requirements provide investors with sufficient information about this issue.

Many of the comments suggest that proxy advisory firms may interfere with, rather than enhance, the communication at the heart of effective engagement. Companies are frustrated by the influence these firms have, and worry that they may not be accountable for, or even concerned with, the quality of the information on which they make voting recommendations.

And, when boards believe that a recommendation has been based on incorrect information, those recommendations can act as a barrier to boards’ efforts to persuade investors to change their minds. A related fear is that proxy firms’ conflicts of interest may be insufficiently disclosed, preventing shareholders from considering possible conflicts when analyzing those recommendations.

As a result of the comments we’ve gathered, the Commission is considering how to provide guidance on how the federal securities laws should regulate the activities of proxy advisory firms.

We are also examining uncertainty surrounding vote confirmation. Currently, in many instances, investors are not able to receive confirmation that their votes have been cast and accurately counted. This inability to confirm voting information is caused in part because no one individual participant in the voting process—neither issuers, transfer agents, vote tabulators, securities intermediaries, nor third party proxy service providers—possesses all of the information necessary to confirm whether a particular shareholder's vote has been timely received and accurately recorded.

And so, we are considering how to require participants in the voting process to share information with each other in order to allow for vote confirmations.

Beneficial Ownership

Next year, we plan to begin a broad review of our beneficial ownership reporting rules. We think it's important to modernize our rules, and we are considering whether they should be changed in light of modern investment strategies and innovative financial products.

Issues that we will consider include:

- Whether the 10-day initial filing requirement for Schedule 13D filings should be shortened;
- Whether beneficial ownership reporting should be changed with respect to the use of cash-settled equity swaps and other types of derivative instruments;
- How the presentation of information on Schedules 13D and 13G can be improved.

The Dodd-Frank Act has provided the Commission with new statutory authority to shorten the 10-day filing deadline for 13D, as well as to regulate beneficial ownership reporting based on the use of security-based swaps. And, earlier this year, the SEC received a petition for rulemaking recommending amendments to Regulation 13D-G.

The petition asks the SEC to broaden the definition of beneficial ownership to include interests held by persons who use derivative instruments. The petition also specifically requests that the time period within which initial beneficial ownership reports must be filed be shortened to one calendar day because technological advances have rendered the 10-day window obsolete.

Many feel that the 10-day window:

- Results in secret accumulation of securities;
- Results in material information being reported to the marketplace in an untimely fashion; and
- Allows 13D filers to trade ahead of market-moving information and maximize profit, perhaps at the expense of uninformed security holders and derivative counterparties.

In response, some argue that:

Tightening the timeframe may reduce the rate of returns to large shareholders, and thereby result in decreased investments and monitoring of and engagement with management;

- There is no evidence that changes in trading technologies and practices have led to significant increases in pre-disclosure accumulations of large ownership stakes; and that

- State law developments, such as the validity of poison pills, staggered boards and control share statutes, have tilted the regulatory balance in issuers' favor.

Our first step will likely be a concept release given the controversy surrounding some of the issues.

Proxy Access

One of the most important means of communicating with a company is through providing input on the directors considered for election. And so, we were disappointed by the court decision striking down the proxy access regulation adopted in August of 2010.

I believe that, as a matter of fairness and accountability, long-term significant shareholders should have a means of nominating candidates to the boards of the companies that they own. I should note that nominating a director candidate is not the same as electing a candidate to the board. I have great faith in the collective wisdom of shareholders to determine which competing candidates will best fulfill the responsibilities of serving as a director. The critical point is that shareholders have the ability to identify alternatives and for all shareholders to make an informed choice.

However, while the court's decision vacated the proxy access rule, it did not impact Rule 14a-8 or the related rules and amendments adopted concurrently with proxy access, which will increase shareholder access to the proxy ballot in key circumstances. Under those amendments, shareholders will be able to submit shareholder proposals for proxy access at their individual companies — a process known as "private ordering."

Rule 14a-8 provides an opportunity for a shareholder owning a relatively small amount of a company's securities to have his or her proposal placed alongside management's proposals in that company's proxy materials a vote at an annual or special meeting of shareholders. There are several procedural requirements that a shareholder must satisfy to have a proposal included in the company's proxy materials — including ownership of at least $2,000 or 1% of the company's securities entitled to be voted for at least one year. Within the parameters of Rule 14a-8, shareholders will now have the chance to ask their fellow shareholders to support a proxy access system at their companies.

Although I still would very much like to provide a mandatory proxy access rule, the availability of Rule 14a-8 for private ordering has the potential, over time, to bring about a system where more and more companies allow shareholders to include their nominees in the company's proxy. This can only enhance engagement.

Say-on-Pay

Perhaps the most visible increase in communication from shareholders to boards is the so-called "say-on-pay" rule — a rule that is also demonstrating the willingness of boards to respond when receiving a clear message from a company's owners.

In the years leading up to Dodd-Frank, there was a feeling that the conversation between shareholders and boards regarding executive compensation was unsatisfactory. We heard complaints that the compensation disclosures provided were too dense to penetrate, too complex to analyze and too obtuse to persuade.

I am pleased to report today, then, that it appears that the say-on-pay regulation put in place through Dodd-Frank is leading to improvements in communication in both directions. It has given shareholders a clear channel to communicate to the boards their satisfaction — or lack of satisfaction — with executive compensation practices. And it is giving boards a powerful incentive to clarify disclosure to shareholders, and to make a clear, coherent case for the compensation plans they have approved.

The rules require companies to provide shareholders with an advisory vote on executive compensation at least once every three years. The rules also require an advisory vote on the frequency of say-on-pay votes at least once every six years.

In addition, companies must provide a separate advisory vote regarding certain "golden parachute" arrangements in connection with a merger, acquisition, or other disposition of all or substantially all, assets.

The outcomes of these votes are not binding on the company or its board of directors, and they do not affect the validity of executive officer compensation arrangements. The advisory vote does, however, let boards know what shareholders think of compensation arrangements.

Companies are required to quickly report on Form 8-K the results of these votes, and I know that there is tremendous interest in the outcome of these votes. In addition, companies have to report the decision on the frequency of say-on-pay votes. And, going forward, companies will have to disclose in proxy statements, in the year following the vote, how they have responded to the most recent say-on-pay vote.

I am heartened that we are beginning to see companies filing proxy statements following say-on-pay votes that are, in fact, responding to these issues.

Conclusion

Effective governance is an imperfect art; the rules of engagement are case specific and can vary dramatically from company to company, while yielding satisfactory results. Given the diversity of approaches, the SEC's focus is on variables through which we feel we can have a beneficial impact on engagement — where we can increase the quality of communication and the level of responsiveness in the board-shareholder dialogue.

Say-on-pay, which is already improving the quality of communications, and the increased disclosures first present in last year's proxy statements, demonstrate the potential this focus possesses.

I believe that we will see more progress in this regard, as shareholders gain greater access to the proxy ballot, and the proxy system itself is updated to reflect the current state of the financial world.

It's difficult to quantify the benefits of effective engagements, but I believe that they are real. This is why dialogues like this, and efforts like those underway at the SEC are important: a system of corporate governance that was recently anchored in the age of adding machines, hand-delivered mail and dial-up phones — with all the gaps, inefficiencies and clubbiness characteristic of that era — is now moving into an age of laptop computers and instant global communications. The result will be a more robust interaction between shareholders and boards that brings real benefits to investors, companies and the larger economy.

Thank you.