Written Testimony of

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September 21, 2016

Subcommittee on Capital Markets and Government Sponsored Enterprises

Committee on Financial Services

US House of Representatives

"Corporate Governance: Fostering a System that Promotes Capital Formation and Maximizes Shareholder Value"

Introduction

My name is Darla C. Stuckey and I am President and CEO of the Society for Corporate Governance, formerly known as the Society of Corporate Secretaries & Governance Professionals (the "Society"). The Society is a professional association, founded in 1946, with 3,300 members who serve approximately 1,000 public companies, which make up over two thirds of the S&P 500. About half of our members are from small and mid-cap companies. Our members are responsible for supporting the work of corporate boards of directors and their committees and the executive management of their companies on corporate governance and disclosure issues. At our companies, we seek to develop corporate governance policies and practices that support boards in their important work and that serve the interests of long-term shareholders. Our members generally are responsible for compliance with the federal securities laws and regulations, state corporate law, and stock exchange listing requirements. The majority of Society members are attorneys, although our members also include compliance officers and non-attorney corporate secretaries and other governance professionals.
The Society is honored to give testimony before this Committee.

Background

The Subcommittee has asked for our testimony on the following three issues related to the corporate governance of public companies:

- The potential need for reform of Rule 14a-8 of the Securities Exchange Act of 1934
- The current disclosure obligations of publicly traded companies and SEC mandates to modernize disclosure
- The impact of mandatory disclosure obligations and other corporate governance provisions in Titles IX and XV of the Dodd-Frank Wall Street Reform and Consumer Protection Act on corporations and shareholder value

Overview

Each of these topics is part of a larger narrative: US public companies are bearing the brunt of a broken disclosure regime.

Mandated disclosures prompted by individuals or groups advancing their own special interests have resulted in a waste of shareholder money and management time, and an abuse of disclosure rules, particularly Rule 14a-8. Corporate proxy statements (and other disclosure documents) have been used by those insisting that their special interest issues be disclosed, in the hopes that corporations will be shamed into changing their behavior. They believe US

public companies should solve not only our country's, but some of the world's, most intractable social problems. Whether in the form of challenges to the existing materiality standard, abuse of the shareholder proposal process, or new requirements imposed by Congress that offer little meaningful information for investors, the current disclosure regime should be reexamined. It is time to look carefully at where we are and what impact the broken system is having on US publicly traded corporations, the US capital markets, and the cost to the shareholders collectively. We should ask ourselves: is this what we want the federal securities laws to do?

What are the special interests? Any social issue you can imagine: how our political elections should be funded, whether wealth should be redistributed from executives to workers, or how to stop torture in the Democratic Republic of Congo. In the past they included the privatization of social security, nuclear energy use, and doing business in Burma, Angola, China, Kazakhstan or Nigeria. Current hot topics are gender pay equity, the minimum wage, tax inversions, civil rights including sexual orientation and political speech rights, animal rights, and even the sale of firearms. And - based on our members' experience - the next few proxy seasons will likely bring a host of new social issues sought to be resolved inappropriately via the corporate disclosure regime. All of these are in addition to numerous climate change-related requests ranging from studies and reports -- to reductions of and caps on greenhouse gas emissions or hydraulic fracturing.

Specific examples include a request by a shareholder of a pharmaceutical company for a report "on the risks associated with increasing pressure to contain U.S. specialty drug prices" (defined as those that cost more than $600 per month). Another example is a proposal submitted to DuPont asking the company "to create a committee, with members drawn from the employee work force of Du Pont, the union leadership of Du Pont, the management of Du Pont, and any necessary independent consultants, to report on the impact to communities as a result of Du Pont's action in laying off mass numbers of employees, selling its plants to other employers, and closing its plants."

We could cite more examples from our members; however, suffice it to say that nothing is off-limits for a shareholder proposal under the modern day Rule 14a-8. While we agree that most of these are compelling social issues, corporate disclosure documents are not appropriate place to vet and solve these issues.

What are the costs? The costs come in many forms: regulatory and compliance costs to capture, analyze, disclose, test, certify and audit the information required by existing regulations and rules; consulting costs for the companies to gather the information to respond to shareholder requests; legal costs to respond to proposals and for litigation by plaintiffs'

lawyers inevitably prompted by each new socially-driven disclosure mandate; and the lost opportunity cost for boards and management who have to take significant time and use other limited resources to understand and analyze each of the various issues that shareholders or politicians put forth. Yes, the cost is high, and might be justified; unfortunately, many of the disclosures "teach little," to paraphrase former SEC Commissioner Daniel Gallagher.
How did we get to this point? A brief history is illustrative: in the 1970s, there were few ways for social activists to disseminate their message. They had small budgets for publishing pamphlets or other materials. Access to a public company proxy, with 100,000 shareholders (now in the millions) for example, gave them a free way to distribute their message broadly across America.

What members of Congress must remember is that many of the SEC rules predate the Internet. This is important to today's testimony simply because proponents now have alternative ways to reach millions of citizens for free via the Internet. With refined use of technology, even the smallest proponents can access billions of people around the world for nominal cost. While it was never an appropriate use of the disclosure regime, the need for using a corporate proxy statement as a public forum for social issues is moot.

My testimony today will focus on just a few areas that illustrate the waste and abuse associated with our disclosure regime. The first is Rule 14a-8, which allows proponents to submit proposals for corporate proxy statements at annual shareholder meetings. The second is the US Supreme Court's materiality standard, which is the underpinning of the federal securities disclosure rules. Finally, I will address the regulatory disclosure burden on companies from governance reforms that should be helping investors making investment and voting decisions, but which in fact overloads them with meaningless, but costly information.

I. SHAREHOLDER PROPOSALS

The Rule 14a-8 shareholder proposal process needs immediate attention. Rule 14a-8 allows shareholders who have held $2,000 of a company's stock for one year to submit a proposal to be included in the company's proxy statement for a vote by all shareholders. **The rule provides an avenue for communication between shareholders and companies, as well as among shareholders themselves.** However, it has limits. The limits are designed to restrict shareholder proposals to matters of common interest to a significant number of holders, and to preclude a miniscule minority of shareholders from burdening other shareholders with proposals that a majority of shareholders do not favor.

The rule has procedures that must be followed, as well as 13 substantive bases for exclusion. One of the bases for exclusion is Rule 14a-8(i)(12). This provision allows a company to exclude a shareholder proposal if the proposal failed to receive achieve a 3% favorable vote of shareholders the last time it was included, a 6% favorable vote if it was voted on twice in the past five years, and 10% support if it was voted on three or more times in the past five years. If a proposal does not receive these minimum levels of vote support from all shareholders, a proponent cannot resubmit them. These are known as the Resubmission Thresholds.
Under Rule 14a-8, if a proposal receives over 10% support, it can be resubmitted each year thereafter so long as it continues to hit that threshold.

Some of the other substantive bases for exclusion are: Rule 14a-8(i)(1) requests that are not a proper subject for action by shareholders under the laws of the corporation's jurisdiction; (i)(2) actions that would cause the company to violate Federal or State law; (i)(3) statements in a proposal that are false and misleading; (i)(4) something that involves a personal grievance of the shareholder; (i)(5) requests for action relating to operations that account for less than 5% of the company's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year; (i)(7) an action that relates to a company's ordinary business operations; (i)(9) a proposal that directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting, or (i)(10) one that has already been substantially implemented by the company. Unfortunately, succumbing to pressure from special interest groups, the SEC has watered down many of these substantive bases for exclusion so that in reality it is very difficult for companies to receive no-action relief from the SEC when these exclusions are raised.

My testimony will cover just two of the bases for exclusion: resubmission thresholds and relevance, and one procedural issue.

A. <u>Resubmission Thresholds</u>

The Commission should raise the thresholds for resubmission of shareholder proposals. The thresholds have not been changed since 1954. As the US Chamber explained in its Petition for Rulemaking Regarding Resubmission of Shareholder Proposals Failing to Elicit Meaningful Shareholder Support filed by the US Chamber on April 9, 2014 ("Petition for Rulemaking"), https://www.sec.gov/rules/petitions/2014/petn4-675.pdf, the Resubmission Thresholds are crucial to avoid rendering shareholder decisions futile, and to avoid requiring companies to respond to too many proposals of little or no relevance to their businesses.

Notwithstanding this view, to reiterate: the thresholds have not been changed since President Eisenhower was in office.

We strongly believe that Rule 14a-8 needs to be modernized. The most recent attempt to have the thresholds revised was in 1997, when the Commission proposed to raise the thresholds to 6% on the first submission, 15% on the second submission, and 30% on the third. The Commission said at the time that “a proposal that has not achieved these levels of support has been fairly tested and stands no significant chance of obtaining the level of voting support required for approval.”

However, the Commission nevertheless failed to adopt these thresholds. The 1998 Adopting Release explained that it decided not to require higher “Shareholder Support Thresholds” because of “serious concerns” from the shareholder community. The concerns were that the higher thresholds would result in the exclusion of too many proposals—particularly those focusing on social policy issues which at that time tended to receive lower percentages of the shareholder vote.

As noted in the Petition for Rulemaking: “In offering this rationale for rejecting its own proposal, the Commission did not reference its three core mandates under the federal securities laws—protection of investors, facilitation of capital raising, and enhancing the effectiveness and efficiency of the Nation’s capital markets—or how the rejection of its own proposal would serve any, much less all, these core mandates.”

Shareholder proposals are expensive for companies and their shareholders, both in terms of dollars spent on legal fees as well as extra management time and board time. Frequently companies will negotiate with proponents and agree to particular requests such as undertaking a reporting obligation, rather than have a proposal go into the proxy for a vote. Aside from the consumption of time, these types of reports are also commonly expensive, particularly if they require detailed information (which most do).

We know first-hand that the real reason some proponents submit proposals is to get the attention of management for the purpose of engaging with them on issues. Shareholder proponents should be encouraged to seek engagement without the need for a proposal. Eliminating shareholder proposals that don’t get high enough votes does not preclude engagement.

The current 3% threshold is meaningless as a gating mechanism because nearly every proposal that goes to a vote gets 3% support.

The Society recently did a study on voting statistics for shareholder proposals for 1997 and 2015. ISS provided us with the voting statistics for 1997; Proxy Insight provided us with the voting statistics for 2015.

As an initial matter, we found that there was a substantial increase in the number of shareholder proposals that have gone to a vote. In 1997, 386 proposals went to a vote; while in 2015, 585 proposals went to a vote. This is during a time period in which the number of public companies shrunk by approximately a half (7300 to 3700 today). These figures do not include the number of proposals submitted that are withdrawn or excluded through the no action process. Based on this data, in 1997, assuming each proposal went to one company, about 5% of companies had a shareholder proposal on its ballot. In 2015, under the same assumption, almost 16% of companies had a proposal on its ballot. In 2013, the Society's shareholder proposal database--which collects all proposals from members who volunteer to share them in addition to publicly available proposals--had 739 proposals at 396 companies.
Our voting data on proposals for 1997 and 2015 shows the following:

- In both 1997 and 2015, 96% of all shareholder proposals achieved the 3% threshold.

If the threshold had been raised to 5% in 2015, 90% of all shareholder proposals would have made the cut for resubmission.

- In 1997, 77% of all shareholder proposals achieved the 6% threshold. Now 88% of all proposals hit that mark.

If the threshold had been raised to 15% in 2015, 80% of all shareholder proposals would have hit the threshold for resubmission.

- In 1997, 56% of all shareholder proposals achieved the 10% threshold. Now 82% of all proposals receive 10% favorable votes.

Even raising the threshold to 25% in 2015 would have resulted in 63% of all shareholder proposals hitting the mark for resubmission. Raising it to 30% shows that 52% of proposals would have been eligible for resubmission.

The data shows that an increase in the current thresholds is appropriate to maintain the various percentage approval rates consistent with that of 1997. Viewing this, a case can be made for an increase in the thresholds to 6/15/30% as the Commission staff proposed almost 20 years ago. The so-called "failure rate" under the 3/6/10 thresholds of 1997 would compare to current voting patterns under 5/15/25%.

Here's a real example for context. Consolidated Edison shareholders had to vote on essentially the same proposal from Evelyn Y. Davis every year from 1997 to 2012. It was voted on for 16 years in a row and received between just over 10% to 17.1% of votes cast – but still never qualified for exclusion under the existing resubmission thresholds. It was a proposal asking for disclosure of every employee who made more than $100,000 (over the years raised to $250,000):

> RESOLVED: That the shareholders recommend that the Board take the necessary steps that Con Edison specifically identify by name and corporate title in all future proxy statements those executive officers, not otherwise so identified, who are contractually entitled to receive in excess of $100,000 [$250,000] annually as base salary, together with whatever other additional compensation bonuses and other cash payments were due them.

Costs

As noted in the Chamber petition citing a Navigant study (A. Ingraham & A. Koyfman, "Analysis of the Wealth Effects of Shareholder Proposals"—Vol. III, Navigant Consulting, at p. 13 (May 2, 2013) ("Navigant Study"), available at http://www.workforcefreedom.com/sites/default/files/Navigant%20Study%20III.pdf), costs directly incurred by companies have been estimated at $87,000 per proposal -- or if aggregated, $90 million annually. Even using a lower legal cost estimate based on anecdotal discussions with Society members of about $50,000 per proposal, the result for 2015 is about $30 million for companies.

This does not include management and board time, nor does it include SEC staff time and costs. In 2015, according to the SEC Division of Corporation Finance staff, the group had 18 attorneys working on 285 no action requests with an average response time of 39 days per request.

B. <u>Shareholder Proposal by Proxy</u>

> *The Commission should prohibit shareholder proposals "by proxy." A small group of individuals submit numerous proposals to companies without owning a single share, and with NO economic stake in the company.*

Not only is the shareholder proposal process costly for companies, it has also been subject to abuse. SEC Rule 14a-8(b), requires a proponent of a shareholder proposal to provide evidence that he or she has "continuously held at least $2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year" prior to the date a proposal is submitted. This minimum-ownership requirement was adopted to "requir[e]

shareholders who put the company and other shareholders to the expense of including a proposal in a proxy statement to have some measured economic stake or investment interest in the corporation." Amendments to Rule 14a-8, 48 Fed. Reg. at 38,219. Despite this rule, the Commission staff routinely allows individuals, advisors, and attorneys to submit 14a-8 proposals without requiring them to have an economic stake or investment interest in the company.

We do not believe that 14a-8(b) authorizes a shareholder to appoint a proxy or attorney-in-fact to submit a proposal on the shareholder's behalf. While SEC Rule 14a-8(h), 17 C.F.R. § 240.14a-8(h) does authorize a shareholder to appoint a qualified representative **to present a proposal** at the meeting, there is no language authorizing the submission of a proposal by a proxy. Why should a shareholder who has no interest in submitting a proposal be permitted to "lend" his or her shares to an individual with a personal grievance or interest or a socially motivated "investor" who doesn't actually own a single share?

This argument has been raised by numerous companies like Ameriprise Financial, Inc. (December 21, 2012), Apple (December 17, 2013), and The Coca-Cola Company (January 15, 2014), Chevron Corp. (avail. Mar. 11, 2014, recon. denied Apr. 4, 2014) and most recently Baker Hughes (2016). It has been asserted in federal district court in KBR Inc. v. Chevedden, 2011 WL 1463611 (S.D. Tex. Apr. 4, 2011), aff'd 478 Fed. Appx. 213 (5th Cir. June 11, 2012), Apache Corp. v. John Chevedden, 696 F. Supp. 2d 723 (S. D. Tex. 2010) and Waste Connections, Inc. v. John Chevedden Waste Connections Inc. v. Chevedden, 2014 WL 554566 (5th Cir. Feb. 13, 2014), where the US District Court for the Southern District of Texas excluded the proposals. These courts have given companies relief, even though the SEC Staff does not. But it is too expensive and takes too much time for a company to go to court every time they receive a proposal by proxy in order to seek relief.

The SEC staff now allows proponents to submit letters stating that "[t]his is my proxy for Mr. or Ms. Y [the actual shareholder] and/or their designee to forward this Rule 14a-8 proposal to the company" for inclusion in the company's proxy materials. Many times these are "cookie cutter" proposals sent to multiple companies, in multiple years. It is not clear from the letter submitted that the actual shareholder even knows to which company a proposal will be sent or on what topic. For example, in Chevron Corp. (avail. Mar. 11, 2014, recon. denied Apr. 4, 2014), a company submitted a shareholder proposal purportedly on behalf of a shareholder and asked that it – not the shareholder – be identified in the proxy statement as the proposal's "sponsor." After Chevron requested proof that the shareholder had authorized the submission of the proposal, the company provided a letter from the shareholder that was more than a year old and that did not identify: (i) the proposal that had been submitted, (ii) Chevron as the company

to receive a proposal, or (iii) the meeting for which it was submitted. Despite those disconnects between the shareholder and the proposal, the SEC staff denied a no-action request arguing that this proposal was not valid under Rule 14a-8 because it had not been submitted by a shareholder.

Therefore, at a minimum, the Society has asked the Commission staff to require proof that the shareholder has given authority to the proponent to submit a *specific* proposal to a *specific* company, for a *specific* annual meeting. We understand that some proponents may assist a group of interested shareholders by "representing" them in the proposal process. However, so much abuse has occurred with these types of submissions, that it is impossible for companies to determine whether a proposal actually reflects the interests of the shareholder rather than the proponent, who is not a shareholder.

More recently, a registered investment advisor was allowed to submit a proposal for one of its clients with a letter from a separate brokerage firm stating that the client/shareholder owned the shares. Yet there was nothing from the actual shareholder stating that the investment advisor was authorized to submit the proposal on the shareholder's behalf. Instead, the advisor relied on the fact that since the advisor was registered, it had certain duties to represent its clients faithfully. The advisor stated that it was authorized to submit a proposal on the shareholder's behalf "since it is clear that as a Registered Investment Advisor registered with the SEC, [it represents] clients of all types and [has] both ethical and legal obligations to do so faithfully."

Proposal recipients - our members – do not understand why the Staff allows this, as it only encourages abuse of the 14a-8 process, allows evasion of its eligibility requirements, and undermines the policy reasons for the shareholder proposal process. In fact, on the SEC website, the stated purpose of the Rule is to provide **an avenue for communication between shareholders and companies, as well as among shareholders themselves.** That is not in fact what is happening. The Rule allows non-shareholders to submit proposals and companies cannot communicate with the actual shareholder; nor is the actual shareholder communicating with other actual shareholders.

This is an abuse of the shareholder proposal system. We believe the Staff should issue a Legal Bulletin clarifying the plain language of 14a-8: a proponent must be a shareholder with an economic stake in the company. Unlike the right to vote, the right to submit a shareholder proposal should not be freely assignable.

Finally, the $2,000 ownership threshold should also be reviewed. It has not been changed since 1998 when it went from $1,000 to $2,000. We would be pleased to offer more thoughts on this if the Subcommittee so desires.

C. Relevance Rule

Rule 14a-8(i)(5), also known as the relevance rule, should be interpreted so as not to gut the economic tests set forth in the rule.

There is one other exclusion that was intended to protect against abuse of the shareholder proposal process that I would like to raise here. Rule 14a-8(i)(5) provides that a proposal is excludable when the proposal relates to operations that account for less than 5% of the company's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year*, and is not otherwise significantly related to the company's business*. It is known as the "relevance rule."

Five percent is a commonly used "rule of thumb" threshold used to evaluate materiality. However, in interpreting Rule 14a-8(i)(5), the Staff has refused to allow companies to exclude proposals from proxy statements when they relate to matters that fall below the 5% economic thresholds if the proposals are deemed to be of social or political "significance" to the company's business. In fact, Rule 14a-8(i)(5) is rarely applied today because the Commission and its Staff interpretations provide that a proposal is "significantly related" to a company's business if the proposal meets the significant policy exception in the ordinary business exclusion. Thus, a company with operations related to the subject matter of the proposal – even if below the 5% thresholds, cannot exclude it.

Here's an example. Assume a proponent does not believe a company should be doing business in Myanmar because of human rights concerns in the country. Even if less than 1% of a company's revenues are from Myanmar, the company must include the proposal in its proxy statement because the Commission has said that the issue of human rights is a significant policy issue. Why should a company with minimal revenues from or assets in a country have to publish (at its own expense) a manifesto of a social proponent? This is a waste of resources.

One easy fix therefore is to ask the SEC to bring logic back into its interpretation of the relevance rule, at a minimum. If a socially active shareholder wants access to a corporate proxy statement, he or she should demonstrate that the issues are relevant to at least 5% of the company's business. That is the rule. If it is not material to investors under the federal securities laws, it has no business in the proxy.

Last, as previously mentioned, the SEC Staff has interpreted several exclusions to shareholder proposals provided in Rule 14a-8 in favor of proponents, so that they basically no longer exist.

This is particularly true for the ordinary business exclusion in 14a-8(i)(7) and the competing proposals exclusion in 14a-8(i)(9). While we have not taken them up here, we would be happy to provide further testimony on the need for reform in the future if the Subcommittee is interested.

II. MATERIALITY AND DISCLOSURE EFFECTIVENESS

> *The materiality standard as promulgated by the U.S. Supreme Court should not be changed.*

The Commission has as its mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. There is no better way to protect investors than to require companies to provide clear disclosure of material information. Materiality is the foundation upon which disclosure is made under the US securities laws. One could say it follows the Goldilocks rule: Not too much, not too little, but just right. However, getting it just right is not easy. Luckily, there is a test promulgated by the US Supreme Court:

> The general standard of materiality that we think best comports with the policies of Rule 14a-9 is as follows: An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

But just because a reasonable investor might consider a fact important, does not mean the fact is material. In fact, the U.S. Supreme Court explained that a low standard of materiality could result in too much disclosure, namely that "management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision making." TSC, at 448-49. Who is this "reasonable investor"? We assume that a reasonable investor makes investment and voting decisions based on maximizing financial value. Having a specific interest does not make an investor "reasonable". In fact, we would posit that a reasonable investor is one who does not have a particular social agenda.

We applaud the SEC for undertaking its Disclosure Effectiveness project. We believe that many prescribed disclosures can and should be eliminated, particularly if they are available elsewhere, or are no longer relevant or material. However, we are concerned that the Commission may use the project to require new disclosures in response to pressures from shareholders or other interested groups motivated by special, social interests.

We believe that disclosure should be principles-based and centered on materiality. Although we acknowledge that there is some basic information about a company that should be helpful to a broad range of investors, a materiality-centered, principles-based disclosure framework will elicit more relevant and useful information than a strictly rules-based framework.

We note that the SEC's Regulation S-K Concept Release solicits input on sustainability reporting, in particular: (i) whether it is important to voting or to investment decision-making, (ii) whether more reporting would result in immaterial information, and (iii) whether website disclosures are sufficient. Some special interest groups support this disclosure to promote social and environmental change even when in many cases they do not have an investment in a company. Those groups wish to add disclosure to documents filed with the SEC which may not be material in the context of a particular company's business, and which could subject companies to more potential litigation. It would add to the "information overload" which contradicts what we believe is the purpose of the Disclosure Effectiveness project. Finally, many companies voluntarily provide sustainability information in annual published sustainability reports and/or on their public websites.

The Society believes that determining whether line item sustainability reporting is important depends on the company and the industry. Materiality must be determined in the context of a particular company rather than in a vacuum (i.e., absent company-specific facts and circumstances). Further, any line item disclosure that does not seek material information would necessarily result in reporting immaterial information.

We believe that the "reasonable investor" standard is still the proper and best standard - that it adjusts itself and is flexible. As the courts have shown, "reasonable investors" differ and are hard to define absent any context. Because there is a broad diversity of interests among stakeholders, it is not feasible or desirable to cover every aspect in our public disclosure regime. And, the desires of investors are fluid and changing constantly. Consider how investors have viewed ESG (environmental/social/governance) topics in the last 10 years. Climate change has evolved substantially. The issues of human trafficking due to global supply chains was not a priority ten years ago as it is to some today. And data privacy was not an issue ten years ago. If

a new series of disclosures is mandated based on today's "hot topics," in a few years, companies will be reporting on things that that are no longer relevant. For example, the notion of reporting on board gender diversity may soon be outdated as gender identification changes.

In closing we must also consider the following:

1) The SEC is the federal agency (subject to Congressional oversight) responsible for public company disclosure requirements. It should not let other quasi-governmental or interested bodies who claim to be standard setters (e,g., the Sustainability Accounting Standards Board), usurp that role.

2) Writing an actual "materiality" rule would be impossible. What is material for one company is based on the facts and circumstances of that company. For this reason, we believe the U.S. Supreme Court definition remains the best test.

3) Not every piece of information important to an investor needs to be in a publicly filed document subject to certification requirements and the attendant liability. In this new tech era, companies have greater flexibility to communicate information outside of traditional '34 Act regulatory filings. Most will agree that a great deal of helpful ESG and sustainability reporting is posted on corporate websites or in other standalone published reports.

4) Whether there is potential substantial investor harm because our disclosure regime lacks mandatory ESG disclosure outside of current materiality requirements (e.g., Risk Factors, MD&A, etc.) should be considered. We believe there is no evidence of any such harm at this point. However, if a company has material undisclosed ESG risks, current SEC rules cover that scenario and should be enforced.

5) Significant resources are being spent on managing corporate disclosure, so any new required disclosure items should be weighed against the already significant burden. Companies have different methods to manage this process. Some large sophisticated companies use internal teams who oversee substantially all aspects of this process. Smaller companies may use outside counsel and advisors. Significant resources, both time and money, are required to support the disclosure process for any company - regardless of size.

II. TITLES IX AND XV OF THE DODD-FRANK ACT

Finally, the Subcommittee has asked us to comment on the mandatory disclosure obligations and other governance provisions in the Dodd-Frank Wall Street Reform and Consumer

Protection Act and their impact on shareholder value. The Society is not aware of any provision in Titles IX or XV that create shareholder value.

In fact, the costs on companies to comply with the mandates, has and will continue to be, substantial. There is no better example of this than Section 953(b), the CEO-median worker pay ratio rule. This rule requires companies to disclose the ratio of the principal executive officer's total compensation against the compensation of the median worker. Coming back to the theme with which I began, the pay ratio rule is an attempt by a special interest group to force a corporation to "disclose" something it believes to be embarrassing and which will change behavior and cause social change. The proverbial scarlet letter. As former Commissioner Daniel Gallagher said in his Dissenting Statement at an Open Meeting to Adopt the "Pay Ratio" Rule:

> The purpose of this rule is not to inform a reasonable investor's voting or investment decision. The AFL-CIO, which lobbied for the rule's inclusion in Dodd-Frank, has explained for us its true purpose: "Disclosing this pay ratio will shame companies into lowering C.E.O. pay." And, "They will be embarrassed, and that's the whole point." But addressing perceived income inequality is not the province of the securities laws or the Commission. And yet here we are, on the cusp of adopting a nakedly political rule that hijacks the SEC's disclosure regime to once again effect social change desired by ideologues and special interest groups (footnotes omitted).
> https://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-to-adopt-the-pay-ratio-rule.html

The trifecta of the "say on pay" vote, conflict minerals disclosure, and the pay ratio disclosure feels like "piling on" in the words of one commentator. "Somewhere along the line there needs to be some objective assessment of whether the putative value of these requirements that Congress is piling on to companies justifies the burdens the requirements impose on companies."

Justifying the burden requires a cost analysis. The Center on Executive Compensation estimates that the compliance costs to companies for the pay ratio rule will be about $189 million. (See report of Dr. Stuart Gurrea and Dr. Jonathan Neuberger of Economists Inc. to review the estimates and assumptions in the Commission's cost-benefit analysis and to conduct its own cost estimate based upon the responses from the Center's survey.)

And added to that, the rule will have an impact in terms of indirect financial and competitive costs. For example, in response to the survey conducted by the Center on Executive

Compensation and the Society, 55% of respondents said they anticipate the pay ratio disclosure will impose indirect financial and competitive costs (e.g., adverse impact on sales, brand damage, increased public relations costs). These comments are noteworthy:

- "Our competitive advantage, recognized by analysts and our shareholders is our low cost country footprint which provides a distinct disadvantage when calculating a global pay ratio."
- "Certain marketing groups and NGO's will likely use the data to embarrass the company and will work to drive certain customers to other vendors or alternate sources."
- "Most or all of our direct competitors are foreign private issuers and will not be subject to the disclosure, putting us at a competitive disadvantage."
- "The sole purpose of the disclosure is to enable organized labor to further incite union activity within the work force. This will no doubt increase costs to address labor risks and cost jobs."
- "While shareholders generally see little value in this ratio, this type of measure ends up being a tool for those with an agenda to cause disruption and controversy; the response to which diverts attention and drains resources from more productive activities (like creating more jobs). It is the unintended consequences that will be the real cost, which is why this continues to be a bad idea."

The pay ratio rule, as finally adopted, gives some flexibility to corporations to determine their median employee, in an attempt to ease the financial burden; however, it remains unworkable in that it requires inclusion of non-US employees and temporary part time and seasonal employees, as well as those of all consolidated subsidiaries.

Add this to the conflict minerals disclosure rule, and you get costs in the billions. The cost of compliance with the conflict minerals rule has been estimated at approximately $710 million according to a new Tulane University and Assent Compliance study.
Last month's GAO Report: http://www.gao.gov/assets/680/679232.pdf, also notes that even at this price, companies are having challenges determining whether their products are free of minerals from the Democratic Republic of the Congo. And more importantly, there is no apparent evidence that violence has been reduced as a result of their significant efforts.

Summary

In conclusion, the Society thanks the Subcommittee for soliciting our views. Our recommendations are as follows:

1) The corporate proxy should not be used as a vehicle for special interest proposals unless a substantial number of shareholders support them. For this reason, Rule 14a-8 should be reformed to increase the proposal resubmission thresholds, and to require proposals from actual shareholders with an economic interest in the company.
2) The existing materiality standard set forth by the US Supreme Court should not be changed. Any contemplated new disclosure items, including ESG or other sustainability metrics, should be subject to the materiality standard in which case, they are already covered by existing, principles-based SEC requirements.
3) The burdens of the corporate governance provisions of the Dodd-Frank Act have been, and will continue to be, substantial. We do not believe that the purported benefits of conflict minerals disclosure, pay-ratio disclosure, and other compensation-related disclosures outweigh the costs to companies. Nor do we think they provide even remotely relevant information; rather, they are merely designed to “name and shame.”

We would be pleased to respond further to any issues that are particular interest.