National Investor Relations Institute

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FINANCIAL REGULATORY REFORM ISSUES

Mission

Through its collaborative community, NIRI advances engagement in the capital markets and drives best practices in corporate disclosures, governance, and informed investing.

Advocacy Accomplishments

Since this document was last updated in March 2014, there has been significant progress on various regulatory issues that impact investor relations professionals and public companies. Here are some of the most notable developments:

- June 2014: The U.S. Securities and Exchange Commission issued staff guidance that directed investment managers to more closely oversee the work of the proxy advisory firms they hire.

- October-December 2015: NIRI, NYSE, and Nasdaq submitted rulemaking petitions that asked the SEC to adopt a short-position disclosure rule.

- August 2017: U.S. Senator Tammy Baldwin introduced bipartisan legislation to modernize the 13D disclosure rules to provide more transparency around hedge fund activism. The Senate Banking Committee considered this bill during a hearing in June 2018.

- December 2017: The U.S. House of Representatives approved bipartisan legislation introduced by Rep. Sean Duffy to direct the SEC to regulate proxy advisors.

- September 2018. After rescinding two no-action letters that encouraged investment managers to rely on proxy advisors, the SEC convened a proxy system roundtable in November 2018.

- February 2019: More than 300 companies signed a joint Nasdaq letter that asked the SEC to adopt proxy advisor reforms and to improve issuer-investor communications by repealing the OBO-NOBO rule.

- May 2019: The SEC said it plans to propose a rule on proxy advisors by April 2020. The Commission also said it would host a roundtable on short-termism in the market.

Advocacy Agenda

1. NIRI supports equity ownership position transparency – full and frequent ownership disclosure by *all* institutional investors (mutual funds, hedge funds, activist investors, etc.) including:
    - Long equity positions
    - Short equity positions
    - Derivative positions

2. NIRI supports comprehensive reforms to the current shareholder voting and communications system in order to improve engagement between public companies and their shareholders.

3. NIRI supports increased transparency and regulatory oversight of proxy advisory services and the processes used by these firms in generating voting recommendations. Institutional investment managers and advisers should take greater responsibility for their voting decisions and provide more disclosure about their proxy votes and use of proxy advisors.

4. NIRI supports a comprehensive evaluation of market stabilizing systems and processes used during times of extreme volatility including some form of short-selling circuit breakers.

5. NIRI supports initiatives to strengthen the initial public offering (IPO) market in the United States, while also protecting investors from fraud. NIRI believes that IPO issuers should be allowed to adopt takeover protections (such as dual-class share structures) to give executives and directors more time to implement long-term growth strategies.

6. NIRI supports efforts to promote long-termism within the capital markets. NIRI encourages companies to provide guidance over a longer term (i.e., one year or more) if they choose to

provide guidance.

7. NIRI supports initiatives to modernize and streamline corporate disclosure rules, and NIRI encourages the SEC to use its regulatory authority to reduce the costs of complying with existing mandates, including Form 10Q reporting requirements. NIRI also asks regulators to allow companies to engage with investors to develop voluntary reporting guidelines on emerging environmental, social, or political issues before imposing costly, one-size-fits-all mandates.

Background

1. **<u>Ownership Transparency</u>**

NIRI recognizes the need for greater transparency within the investment community, and NIRI supports a reporting regime that promotes more timely and frequent long-position reporting, as well as commensurate full and fair short-position disclosure. NIRI urges the SEC to fully implement Section 929X of the Dodd-Frank Act, which requires the Commission to promulgate rules obligating investment managers to publicly report short sale activity *at a minimum* of once every month. NIRI also believes that the benefits to investors and public companies of long-position reporting justify a similarly substantial increase of the frequency of Form 13F reporting.

a. <u>Short-Position Disclosure.</u> In accordance with its mission, the SEC should require the same level of disclosure from *all* institutional investors (investment funds, hedge funds, activists, etc.) maintaining short equity positions as are required of the funds that maintain long equity positions. NIRI, NYSE, and Nasdaq have petitioned the SEC to adopt a short-position disclosure rule. NIRI believes that short-position reporting and corresponding share lending reporting should be publicly available in the same manner as long-position reporting. In addition, NIRI believes long- and short-position reporting should occur on a more frequent basis, and that requirements should be the same for all investors.

b. <u>Form 13F Revisions.</u> Publicly traded companies currently operate in an environment of great transparency governed by federal, state, and stock exchange rules and regulations, but the ownership disclosure rules that apply to institutional investors have not been updated in decades. Current SEC rules generally require institutional investors to disclose share ownership positions on a quarterly basis (through Form 13F filings), with an exception made for those that petition the SEC to delay these disclosures on the basis of confidentiality. In 2013, NIRI and NYSE petitioned the SEC to shorten the reporting deadline from 45 days to two business days after the end of the calendar quarter.

Given the advances in recordkeeping technology in the more than 40 years since the 13F reporting requirement was adopted, there does not seem to be any justification for the existing 45-day deadline. The practical effect of this rule is that an investment manager may, for example, buy or sell shares on January 1 and not have to report that holding change until May 15, more than 19 weeks after the transaction. Many U.S. companies hold their annual meetings during this period, when shareholder communications are even more crucial.

The outdated 13F rules also are a significant impediment to corporate-investor engagement, because companies don't have timely information on all of their investors' positions when trying to allocate scarce C-suite or director time among competing investor requests for one-on-one meetings or calls. NIRI believes that companies need to receive more timely and frequent ownership information (ideally on a monthly basis, with no more than a 10-day delay), so they can treat investors fairly and effectively manage these engagement requests.

However, some investment managers have resisted 13F reform and have raised concerns about preserving the confidentiality of trading strategies. To address these concerns, NIRI would support the creation of a supplemental confidential reporting regime, whereby 13F institutions would report significant positions (e.g., more than 0.5 percent of the company's public float) directly to the lead investor relations officer at the specific issuers where they hold positions. Such reporting could be done on the 10th day of each month and cover significant positions and trading activities by the investment manager during the previous month. The lead investor relations officer would keep this information confidential and would only be permitted to share this information internally with C-suite executives, the Board of Directors, and the IR team for investor engagement purposes. A monthly investor-to-issuer confidential reporting regime, with a 10-day reporting delay, would protect trading strategies while providing more timely information to companies about the institutions that hold their shares. Such a reporting system would promote long-termism by ensuring that companies are responsive to their large long-term holders and by helping companies detect activist investors who use loopholes in the current reporting rules to secretly amass significant positions.

c. <u>Form 13D Revisions.</u> NIRI also supports the modernization of the SEC's 13D reporting rules, which are a relic of the Williams Act of 1968. Under these outdated rules, an activist investor doesn't have to report until 10 days after accumulating a 5 percent stake. As a result, an activist can secretly accumulate large positions (often significantly more than 5 percent) at the expense of other investors and then ambush companies. These activists often pressure executives and directors to agree to plant closings, job cuts, reduced R&D spending, the sale of business units, excessive share buybacks, or other concessions that may not be in the long-term interests of shareholders.

Given the technology improvements over the last several decades and the speed at which information now flows, NIRI sees no reason for such a delay in reporting this material shareholder ownership information to the market. NIRI believes the 13D rules should be amended to reduce the reporting period from 10 days to two days, which would be in line with the reporting periods in international markets. The 13D reporting requirements should be expanded to include long- and short-position information, as well as share lending.

NIRI also supports Senator Tammy Baldwin's "Brokaw Act" bill, which would reduce the 13D reporting period to four days and expand the 13D disclosure requirements to cover derivative transactions, such as cash-settled swaps, that have been used to conceal ownership.

2. Shareholder Communications/Proxy System Reforms

More than 75 percent of the shares of U.S. public companies are held in "street name," meaning that they are held in the name of a third-party financial intermediary, such as a broker or a bank. This system ensures an efficient transfer of shares among owners and promotes liquidity in our capital markets, but this ownership structure complicates the efforts of companies to communicate with their shareholders.

In addition, short-selling practices, complex derivative transactions, empty voting, and an outdated shareholder voting process are now challenging the integrity of the proxy voting system. Brokers and other financial institutions are not able to accurately account for shares that are entitled to vote on important corporate matters. Hedge funds and other financial players are using share lending and swap transactions to separate economic interest from voting rights, in order to influence the results of a shareholder meeting. Empty voting schemes that offer the opportunity to manipulate corporate governance affairs and stock prices should be prohibited.

The current shareholder voting and communications system is more than 30 years old and needs to be updated and reformed. Public companies are not able to use modern technology to communicate with individual investors who own shares in their enterprises. For the protection of individual investors and other participants in our capital markets, the SEC should focus on the following changes:

a. Direct Communication with Individual Investors. The SEC should eliminate the "Non-Objecting Beneficial Owner" (NOBO) and "Objecting Beneficial Owner" (OBO) classifications, which greatly hinder the ability of companies to communicate with their retail investors. Public companies should have access to contact information for all of their beneficial owners and should be permitted to communicate with them directly.

   If these classifications are eliminated, those beneficial owners wishing to remain anonymous should be permitted to register their shares in a nominee account (or enter into a custodial arrangement) with their broker, bank, or other third-party intermediary. Shareholders who are currently classified as OBOs should have adequate notice of the elimination of their OBO status to permit them to decide whether to establish a nominee account or enter into a custodial arrangement.

   Communications with beneficial owners should only be for purposes involving the corporate affairs of a company. Federal privacy regulations should apply to the use of beneficial owner information received from a broker or a bank.

b. Voting by Retail Investors. The SEC should continue to examine how to protect the vote of the retail investor, particularly in the case of unvoted shares. Institutional investors generally vote almost 100 percent of the time in order to meet their legal responsibilities. This voting is facilitated by electronic systems, and also aided by third-party proxy advisory services. Retail investors have no similar voting facilitators or proxy advisory services, and, in fact, often have no motivation to vote their shares. The SEC should encourage participation by brokers in the Enhanced Broker Internet Platform/Investor Mailbox program, which may dramatically increase retail shareholder proxy voting participation. NIRI believes that broker and investment advisor websites, which individual shareholders increasingly look to as the sole portal for their investment needs, offer one of the most viable paths for engaging individual shareholders in the voting process. NIRI also supports the use of the omnibus proxy process to permit companies to send proxy cards — instead of voting instruction forms — to beneficial owners. This will ensure that retail investors are treated the same as registered shareholders in the proxy voting process. Obtaining a legal proxy also will permit retail investors to attend shareholder meetings and cast their votes in person, without having to separately obtain credentials from the brokers and banks holding their shares.

c. Transparent Proxy Fees. Brokers, banks, and other intermediaries should not stand in the way of direct communications between companies and the beneficial owners of their securities. Companies should have the ability to determine the distributors of their communications, and all costs for the system should be transparent and verifiable. Fees should be monitored and evaluated regularly by an oversight body that seeks to promote fairness and competition. Unfortunately, the NYSE Proxy Fee Advisory Committee's recommended rule changes, which were approved by the SEC in October 2013, did not call for an independent audit of proxy fees. NIRI believes that a third-party audit of proxy distribution fees is the best way to ensure that fees are reimbursed fairly, equitably, and objectively, thereby eliminating the vested interests of those involved directly and indirectly in the process. Without transparency, many issuers will continue to question the accuracy of proxy fees.

d. Proxy Voting Integrity. The proxy voting process should be fully transparent and verifiable, starting with the compilation of a reconciled list of beneficial owners eligible to vote and ending with the final tabulation of votes cast at a shareholder meeting. The vote counts on matters before a shareholder meeting should be auditable and capable of third-party verification, so that a validation of the final tabulation of the votes of both registered and beneficial owners can occur. Proxy votes should continue to be counted and tabulated using the current practices governed by state law, including, when necessary, the services of an independent inspector of elections.

e. Modernize Definition of Beneficial Ownership. The SEC should undertake a Section 13 rulemaking project to modernize the definition of beneficial ownership to include securities-based swaps. NIRI agrees with former SEC Chair Mary Schapiro that it is important to bring the Commission's beneficial ownership rules up to date "in light of modern investment strategies and innovative financial products." The SEC should require disclosure of both voting and economic ownership along with both positive and negative economic ownership.

f. Investor Education Initiative. A national campaign to educate investors in areas of shareholder communications, shareholder responsibilities, and regulatory requirements is needed to ensure that institutional and individual shareholders are responsible and informed owners.

g. Shareholder Proposal Reform. NIRI supports the modernization of the resubmission thresholds under SEC Rule 14a-8, which address the repeated filing of shareholder resolutions on the same topics at the same companies. NIRI agrees that the current thresholds should be raised to 6 percent, 15 percent, and 30 percent, as the SEC proposed in 1997. NIRI believes that this modest reform would help ensure that corporate proxy statements are not cluttered with special-interest proposals that do not earn broad support from investors.

3. **Proxy Advisory Services**

The SEC, through either a rulemaking proceeding or staff guidance, should exercise greater oversight over proxy advisory services and the processes used by these firms and their investor clients in generating voting recommendations and making voting decisions. NIRI believes that investors may not be protected adequately because of the current deficiencies in regulatory oversight and transparency that exist within the proxy advisory industry. In order to protect investors, consideration should be given to the following recommendations to improve the regulatory oversight and transparency of proxy advisory firms:

Proxy Advisory Firms

a. All proxy advisory firms should be required to register under the Investment Advisers Act of 1940, and be subject to a regulatory framework that reflects the unique role that proxy advisors perform in giving advice with respect to voting securities. This regulatory framework should, at a minimum, address report accuracy, conflicts of interest and internal controls, and provide for public disclosure of the policies, procedures, guidelines, and methodologies used by each proxy advisory firm to develop its voting recommendations.

b. Proxy advisory firms should provide each public company with an advance copy (i.e., 5 business days before issuance) of any report that includes a proxy voting recommendation about such company, to permit the company to review and comment on the factual accuracy of statements made in the report. If a company decides to provide a rebuttal, the proxy advisor firm should add a hyperlink to the front page of its report so that investors can review the company's response before voting.

c. Proxy advisory firms should track the operating, financial, and strategic performance of issuers continuously, so that recommendations are made in the context of how the company is being managed, not solely on the basis of an isolated analysis of a particular issue or a governance policy standard.

d. Proxy advisory firm methodologies should be transparent and made available to issuers *at no charge*, so that investors can better evaluate their recommendations, and issuers can offer suggestions that would improve these methodologies.

e. Proxy advisory firms should fully disclose all potential conflicts of interest (including whether an investor client is a proponent of a shareholder proposal or a "vote no" campaign) in sufficient detail (and in specific research reports) to allow assessment of the proxy advisor's independence. Proxy advisory firms should recuse themselves when clear conflicts exist.

f. Proxy advisory firms should maintain records and certify the votes made by their clients.

g. Proxy advisory firms should make available on their websites without charge (or file with the Commission) a copy of each report that contains a proxy voting recommendation about a public company, no later than 90 days after the shareholder meeting to which the voting recommendation relates.

h. The SEC should require public disclosure of an entire proxy advisory firm report whenever an excerpt of such report is released into the public domain by any person in advance of a shareholder meeting.

i. As an alternative to the registration regime detailed in Section 3(a), NIRI supports an expansion of the various conditions (to encompass the recommendations listed above) that proxy advisory firms must meet to qualify for an exemption from the SEC's proxy solicitation rules.

Institutional Investors/Investment Advisers

a. The SEC should issue a rule or staff guidance emphasizing the responsibility of each registered investment adviser to exercise appropriate oversight over its proxy voting process, including its use of proxy advisory firms, to ensure that its voting decisions with respect to client securities are in the best interests of its clients. The Commission should address the use of automated voting platforms whereby proxy advisory firms cast ballots on behalf of their investment adviser clients without the clients having to take any affirmative action. Investment advisers should provide disclosure (at least annually) on how they utilize the advice of proxy advisory firms in making their voting decisions.

b. To encourage competition and new entries into the concentrated U.S. proxy advisor market, the SEC should encourage investment advisers to seek advice from multiple proxy advisory firms if they rely on proxy firms.

c. The Commission should promote the concept that investment advisers can rely on their overall assessment of the management of the company, which would allow votes consistent with management recommendations if they are generally happy with the direction of the company.

d. The SEC should reaffirm its position that investment advisers are not required to vote on every agenda item, including shareholder proposals, that appear on corporate ballots if the investment adviser determines that the specific agenda item is not material to its investment decisions.

e. Investment advisers should have ongoing communications with companies regarding governance preferences rather than just relying on the advice of proxy advisory firms.

f. As mandated by Section 951 of the Dodd-Frank Act, the SEC should finalize a rule that would require all investment advisers (who are Form 13F filers) to annually disclose their proxy votes on "Say on Pay" and certain other executive compensation matters. This rule would increase transparency and provide greater insight to issuers about the proxy voting preferences of their investors. Given the importance of voting transparency, the SEC should consider extending this requirement to include votes cast by 13F filers on other proxy matters.

4. **Market Volatility**

NIRI supports a comprehensive evaluation of market stabilizing systems and processes during times of extreme volatility, including implementation of some form of short selling circuit breakers during these periods.

5. Public Capital Markets

Given the significant decline in the number of U.S. public companies since the 1990s, NIRI encourages the SEC to remove regulatory barriers that discourage companies from going public.

NIRI thanks the SEC for its recent efforts to reduce costs for pre-IPO companies, such as through its February 2019 proposal to extend the "testing the waters" accommodation to all prospective issuers. NIRI also welcomes the SEC's May 2019 proposal to exempt low-revenue smaller reporting companies (SRCs) from the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, although NIRI believes that all SRCs should be exempt from this costly mandate. NIRI also encourages the SEC to harmonize its smaller reporting company and non-accelerated filer definitions to reduce confusion among companies and investors.

NIRI opposes efforts to preclude IPO companies from adopting takeover defenses (such as dual-class structures) or the exclusion of issuers with such defenses from stock market indexes. NIRI believes these efforts could expose newly public companies to short-term activism and deter private companies from going public. Companies should have the flexibility to adopt dual-class ownership structures (or other defenses) when they go public if the company's management – after consulting with the company's pre-IPO investors – determines that such an ownership structure would give executives and directors more time to develop and carry out a long-term growth strategy. Investors should have the freedom to choose among issuers with varying corporate governance structures that are tailored to each company's unique circumstances.

NIRI also is concerned about the decline in equity research coverage for smaller issuers, a trend that likely will accelerate in the wake of the European Union's MiFID II rules. Companies with no analyst following have significantly greater difficulty in attracting new investors, as many institutional fund managers won't invest in issuers that lack coverage. NIRI encourages the SEC to work with broker-dealers, independent research providers, investment managers, and IR professionals to develop recommendations to promote more research coverage of small- and mid-cap companies.

6. Long-Termism and Guidance

NIRI supports efforts (through regulation and industry best practices) to promote a greater long-term focus throughout the capital markets.

NIRI believes that an undue focus on short-term, single-point earnings guidance is undesirable and that all relevant audiences – primarily investors, financial analysts, and the news media – are better served when companies focus their guidance communications on long-term business strategy and value drivers. If a company chooses to provide guidance, NIRI recommends that it provide long-term guidance (i.e., one year or longer) on a consistent set of financial and non-financial metrics that, together, constitute the key long-term value drivers of its business.

When providing any form of guidance, NIRI encourages companies to provide a range of reasonable potential outcomes for each timeframe and metric (versus a single point or an unreasonably narrow range) to help investors and analysts better understand the inherent variability of its business and to drive discussion related to the strategies that management is employing to capitalize on market opportunities.

While companies are encouraged to provide longer-term guidance, NIRI acknowledges that there will be circumstances when a company may need to furnish short-term guidance, for example, to address seasonality or an unexpected market development, or to be consistent with the practices of industry peers.

7. **<u>Disclosure Reform</u>**

NIRI supports the modernization of corporate disclosure rules and the removal of requirements that are obsolete or no longer generate material information for investors. NIRI thanks the SEC for its recent efforts to streamline and simplify Regulation S-K requirements. NIRI also welcomes the SEC's review of quarterly reporting practices and urges the SEC to fully consider corporate suggestions by Nasdaq and others to reduce the costs of Form 10Q filings. These filings often repeat much of the content within earnings releases, are typically filed on the same day (or within a few days) of the release, and thus are not read by many investors.

While some investors have urged the SEC to adopt new disclosure rules on climate change, human capital concerns, and other public policy matters that may not be material for all companies and their investors, NIRI believes that regulators should proceed cautiously before adding to corporate disclosure burdens. It is better to wait and assess how companies respond voluntarily to investor requests on emerging environmental, social, or political issues before mandating new disclosures that may get buried in lengthy SEC filings. NIRI encourages public companies to work with their industry associations, largest investors, and research analysts to develop voluntary reporting guidelines that would result in more useful disclosures for investors and analysts.

If Congress decides to enact additional disclosure legislation in the future, the SEC should use its regulatory discretion and consider suggestions from issuers and their advocates to minimize compliance burdens while still carrying out the general intent of the legislation. As NIRI noted in its comment letters on the rules proposed to implement the CEO pay ratio and the "pay versus performance" provisions of the Dodd-Frank Act, the Commission should resist imposing significant compliance costs on issuers to produce non-material disclosure that would not be useful for most investors.

<u>About the National Investor Relations Institute</u>

Founded in 1969, NIRI is the professional association of corporate officers and investor relations consultants responsible for communications among corporate management, shareholders, securities analysts, and other financial community constituents. The largest professional investor relations association in the world, NIRI's more than 3,300 members represent 1,600 publicly held companies and $9 trillion in stock market capitalization. Through its collaborative community, NIRI advances engagement in the capital markets and drives best practices in corporate disclosures, governance, and informed investing.

Approved by the NIRI Board of Directors, June 2019.