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PROXY ACCESS: BEST PRACTICES 2017

This report updates the Council of Institutional Investors' (CII) 2015 guide, "Proxy Access: Best Practices," an overview of the Council's views on common proxy access bylaw provisions. Proxy access, a mechanism that enables shareholders to place their nominees for director on a company's proxy card, gives shareholders a meaningful voice in board elections.

In 2015, proxy access was just beginning to come into widespread adoption on a company-by-company basis. Today, investors have successfully encouraged 60% of the S&P 500 to adopt proxy access. In all, more than 400 U.S. companies have adopted proxy access bylaws as of June 2017, according to research by Covington and Burling. However, while proxy access has gained broad acceptance, some adopting companies have included, or are considering including, provisions that could significantly impair shareholders' ability to use it.

In response, CII has updated its 2015 report with this publication, which includes newly identified provisions. The chart on the following pages highlights the best practices CII recommends for implementing proxy access.

CII's member-approved policy on proxy access states:

Companies should provide access to management proxy materials for a long term investor or group of long-term investors owning in aggregate at least three percent of a company's voting stock, to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors.

To allow for informed voting decisions, it is essential that investors have full and accurate information about access mechanism users and their director nominees. Therefore, shareowners nominating director candidates under an access mechanism should adhere to the same SEC rules governing disclosure requirements and prohibitions on false and misleading statements that currently apply to proxy contests for board seats.

CII generally supported a similar approach to proxy access that the Securities and Exchange Commission (SEC) adopted in 2010 but later vacated after a court challenge. CII urges companies that decide to adopt access mechanisms to talk to their shareholders about the approach they prefer and to avoid requirements that make access impractical to use.

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Proxy Access Bylaw Provision	CII Position	Explanation/Basis
OWNERSHIP		
Ownership threshold	CII supports a 3% ownership threshold.	CII’s position is consistent with the SEC’s view that proxy access may not be consistently and realistically viable, even by a group of shareholders, if a uniform ownership threshold were set above 3%. As of July 2017, 97% of companies with proxy access use a 3% threshold.
Date for proving continuous ownership	CII supports requiring nominating shareholders to meet the ownership percentage only on a date at least one week prior to the notice date that is also a date on which the company makes public its outstanding shares. Companies should require that nominating shareholders give proof of ownership from a broker or bank for at least that number—not percentage—of shares for the required holding period.	The 2010 SEC rule required nominating shareholders to meet ownership percentages only once, provided that they have held that number of shares for the entire ownership period, similar to the rules required for submitting shareholder proposals. More onerous ownership documentation could make proxy access unusable.
Ownership before the meeting	CII acknowledges that a three-year holding period has become standard. However, CII policies endorse requiring shareholders to own stock for at least two years prior to using proxy access.	An ownership length requirement of two to three years ensures that shareholders using proxy access have a long-term stake in the company’s continued performance, while preventing investors with short-term ownership from misusing it.

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Ownership after the meeting	CII opposes bylaws that require nominators to hold the requisite amount of stock after the annual meeting.	<p>CII believes that as a practical matter, nominating shareholders may not know their intent to hold, sell or buy shares until after the election. We believe that depending on the outcome of a particular election, the nominator may purchase more stock or sell stock.</p> <p>A pre-filing holding period, coupled with a requirement to hold shares until the date of the meeting, should suffice to achieve the goal of limiting proxy access to longer-term shareholders.</p> <p>CII's position is consistent with the 2010 SEC rule, which provided that nominating shareholders did not need to hold the required percentage of shares after the annual meeting. The SEC did require a statement with regard to a nominating shareholder's intended ownership of the securities after the election of directors (which could be contingent on the results of the election of directors).</p>

Proxy Access Bylaw Provision	CII Position	Explanation/Basis
<p>Loaned Shares; use and recall period</p>	<p>Loaned securities should be counted toward the ownership threshold. If nominators must recall loaned shares in order to count them towards the ownership threshold, they should be given at least a five-day window to collect.</p>	<p>There are valid reasons why, consistent with its fiduciary obligations, a shareholder may lend securities to third parties, while retaining the right to recall and vote those securities. The SEC found that share lending is a common practice, and that loaning securities to a third party is not inconsistent with a long-term investment in a company.</p> <p>Loaned securities should be counted as belonging to a nominating shareholder if certain conditions are met. Specifically, CII has supported a requirement that nominating shareholders or each member of the nominating group may include securities that have been loaned to a third party, provided that the participant represents that it has the legal right to recall those securities for voting purposes, accompanied by a representation that the participant will hold those securities through the date of the annual meeting.</p> <p>If a bylaw requires loaned shares to be recalled, companies should give investors at least five days to do so. Any shorter amount of time may prevent many shareholders from counting their loaned shares towards the ownership threshold, since loan agreements often are made with the requirement that borrowers be given up to five days to return shares.</p>

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AGGREGATION		
Aggregation of shareholders	CII has not supported limits on the number of shareholders that may aggregate their shares to satisfy the ownership requirement, but we recognize that a 20-shareholder cap has become the market standard.	<p>CII believes that shareholders should be allowed to aggregate their holdings in order to meet the ownership eligibility requirement to nominate directors. However, CII recognizes that a 20-shareholder cap has become the market standard and acceptable to many investors if families of funds are counted appropriately (see next item).</p> <p>CII's position is consistent with the 2010 SEC rule, which considered, but rejected, imposing a cap on the permitted number of members in a nominating group. The SEC found that individual shareholders at most companies would not be able to meet the minimum threshold of 3% ownership for proxy access unless they could aggregate their shares with other shareholders.</p>

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Treatment of families of funds	Two or more funds that are under common management and investment control, under common management and funded primarily by the same employer, or are considered a group of investment companies as defined by the Investment Company Act of 1940, should be treated as one stockholder for the purposes of aggregation.	Since proxy access bylaws have coalesced around a 20-shareholder aggregation cap, counting funds under common management and employment as separate entities would make it exceedingly difficult for many institutional investors to meet aggregation and ownership limits. CII believes that these funds should be treated as one shareholder for aggregation purposes, since in practice they act as a single unit.
SHAREHOLDER NOMINEES: NUMBER AND RESTRICTIONS		
Shareholder nominee cap	CII believes that shareholders should have the option to nominate at least two candidates on the company's proxy card.	It is important that shareholder nominees have meaningful representation on the board, and in many or most cases, one director is insufficient to achieve that goal. Having at least two nominees helps ensure that the nominees, if elected, can serve on multiple committees and have greater opportunities to bring an independent perspective into board decisions.

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Adjustments to the shareholder nominee cap after election of proxy access nominees	It is not necessary to adjust the shareholder nominee cap based on directors previously elected through proxy access	A significant minority (41%) of proxy access bylaws provide that director nominees who already serve on the board, and who first were included in company proxy materials in a prior year proxy access nomination, would count toward the limit on proxy access nominations. This would reduce or preclude the possibility of new proxy access nominees. We do not believe this is necessary, unless proxy access nominees from the current and previous two annual meetings would constitute a majority of the board. Proxy access bylaws that include this type of provision should specify a look-back of no more than two years.
Restrictions on re-nomination when a nominee fails to receive a specific percentage of votes	CII opposes restrictions on re-nominations when a nominee fails to receive a specific percentage of votes.	CII believes that since resubmission requirements are not applicable to management’s candidates, they should not apply to candidates suggested by shareholders. CII’s position is consistent with the SEC’s 2010 rule, which considered, but rejected, imposing such restrictions. The SEC did not believe it was necessary or appropriate to include a limitation on the use of proxy access by nominating shareholders or groups that have previously used it. The SEC also found that such a limitation would not facilitate shareholder’s traditional state law rights and would add unneeded complexity.

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Compensation arrangements	CII opposes requirements that limit the pool of eligible candidates based on a compensation arrangement with a party other than the corporation.	<p>Eligibility requirements for director nominations exist to ensure an orderly nominating process. To the extent possible, companies should defer decisions about the suitability of candidates to shareholders in the voting process. More specifically, we believe limiting the pool of eligible board candidates by excluding those who receive candidacy fees would be an inappropriate requirement.</p> <p>We strongly support requiring clear disclosure before the election about any compensation arrangements, including any with parties other than the corporation.</p>
Qualification and disclosure requirements for nominees and nominating shareholders	<p>Nominating shareholders and their nominees should not face additional disclosure requirements beyond what the SEC requires in proxy contests and disclosures that the company stipulates from its own candidates.</p> <p>CII also believes that qualification and independence standards should apply universally to shareholder and management nominees.</p>	Nominating shareholders and proxy access candidates should not face more rigorous standards than those applied to shareholder proposal filers and management directors, respectively. CII believes that reasonable levels of disclosure benefits shareholders, but burdening proxy access candidates and nominators with onerous reporting requirements not applicable to the board’s nominees is unfair and could potentially make proxy access unworkable. This includes requirements on oral communications and communications unrelated to proxy access that extend beyond what is required under SEC rules.

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MISCELLANEOUS		
Concurrent use of proxy access and proxy contests	CII opposes automatic suspension of proxy access for all shareholders in the event of a proxy contest. CII does not, however, oppose provisions barring a shareholder group from waging a proxy contest and utilizing proxy access simultaneously.	Consistent with the 2010 SEC rule, CII opposes broadly limiting proxy access on the basis that another shareholder, or another group of shareholders, has launched a proxy contest. CII believes that in a proxy fight with up to two dueling proxy cards, shareholders would still benefit from having the option of voting for at least two shareholder nominees on the company's proxy card. In the case of proxy access nominees, the candidates would be nominated by long-term shareholders who may differ from activist shareholders running a proxy fight based on short-term financial engineering or other goals in tension with long-term holders.
Limits on the length of supporting statements	CII expects companies to provide the same space and treatment in the proxy statement for shareholder nominees that they extend to their own candidates.	Equal space and treatment allows shareholders to make informed decisions when voting.
Authority to interpret proxy access bylaws	The ability to interpret proxy access bylaws should not rest in the sole discretion of the board. Instead, disputes over interpretation should be subject to judicial review, consistent with other bylaw provisions.	Proxy access bylaws should be subject to the same judicial review as other provisions in the governing documents, with both companies and shareholders retaining the right to seek judicial view or actions they deem materially inconsistent with the bylaws.
Indemnification	CII opposes unlimited indemnification requirements on nominating shareholders.	Companies should avoid unnecessarily broad indemnification language that could be used to inhibit the proxy access process.