NATIONAL ASSOCIATION OF Manufacturers

Testimony of

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Hearing on

"Reforming the Proxy Process to Safeguard Investor Interests"

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Good morning Chairwoman Wagner, Ranking Member Sherman and members of the Subcommittee on Capital Markets. My name is Chris Netram, and I am the Managing Vice President of Policy at the National Association of Manufacturers. On behalf of the NAM and the millions of people who make things in America, I appreciate the opportunity to testify before today's Subcommittee hearing on *Reforming the Proxy Process to Safeguard Investor Interests*.

The NAM is the largest manufacturing association in the United States, representing nearly 14,000 manufacturers of all sizes and in every industrial sector. Manufacturers are dedicated to creating products and processes to improve the quality of life for all Americans; every day, innovators throughout our industry pioneer groundbreaking new technologies and celebrate America's entrepreneurial spirit.

When the manufacturing industry succeeds, America succeeds. Manufacturers employ nearly 13 million Americans from all walks of life, paying $95,990 on average in wages and benefits. Manufacturing's annualized contribution to the U.S. economy was $2.9 trillion as of the first quarter of 2023; by itself, manufacturing in the U.S. would be the eighth-largest economy in the world. And manufacturers are continuing to invest in growth—monthly construction spending in the industry rose to a record $193.88 billion in May of this year—while performing more than 55% of all private-sector research and development. This growth bolsters U.S. competitiveness on the world stage, especially as China continues to work toward its ambition of becoming the world leader in advanced manufacturing.

Manufacturing is a capital-intensive industry. As such, the industry's strength depends in large part on companies' ability to raise the funds necessary for critical investments in equipment, machinery, facilities and R&D. Many manufacturers turn to the public market to access this capital, which supports job-creating projects and robust partnerships with businesses of all sizes, including small and medium-sized businesses, throughout the manufacturing supply chain.

When manufacturers offer their shares to the public, it allows everyday Americans to participate in the industry's success, largely through passive investments like mutual funds, pension plans and 401(k) accounts. The fiduciary relationship between publicly traded companies and their

shareholders lies at the bedrock of America's world-leading capital markets. Manufacturers' management teams and boards of directors must act in Main Street investors' long-term financial best interests, and those investors have the right to hold company leaders accountable via the proxy ballot.

The proxy process historically has been governed by state law, with required proxy votes generally limited to significant items like the election of the board of directors or referenda on the sale of substantially all of a corporation's assets. These votes allow a shareholder to exercise appropriate oversight of a company while also ensuring that its board and management can act, consistent with their fiduciary duty, in the financial best interests of the entire shareholder base.

Unfortunately, in recent years manufacturers have experienced an influx of third parties seeking to divert the proxy ballot from long-term value creation for shareholders and toward a political and social agenda with little if any nexus to a company's business. This parade of activist groups and proxy advisory firms are enabled by a lack of appropriate regulatory oversight from the Securities and Exchange Commission. In fact, the SEC over the past two years has taken proactive steps to support and empower these third-party actors—rescinding much-needed guardrails, limiting companies' ability to exclude activist proposals from the proxy ballot and encouraging environmental, social and governance agendas unrelated to long-term business growth and shareholder returns. These changes are emblematic of the regulatory onslaught that manufacturers are currently experiencing from all corners of the federal government.

The increasing politicization of the proxy ballot has a significant impact on manufacturing. For businesses, each shareholder proposal imposes direct costs in excess of $150,000,[1] to say nothing of the public relations risks associated with being pressured to opine on controversial topics over which they have little control. Those funds would be more efficiently utilized investing in job-creating projects and groundbreaking R&D, especially as companies receive more and more proposals each year, driving up the aggregate cost. Every dollar spent on manufacturing investment has a total impact of $2.60 on the U.S. economy, and every job created in manufacturing leads to 4.4 jobs elsewhere—so the resource diversion associated with publishing and responding to activist proposals can be particularly damaging in our industry. These impacts are particularly acute for smaller businesses, both those directly impacted by ESG activists and those operating within public companies' supply chains.

In addition to these risks to manufacturing growth and job creation, manufacturing workers also are impacted because many have a stake in the industry via employer-sponsored retirement plans or other investment accounts. More than 70% of manufacturing employees participate in a workplace retirement plan,[2] and the ability of a single-issue activist with *de minimis* holdings in a business to dictate the content of its proxy ballot and exercise outsized influence on its corporate decision-making can only threaten these employees' financial stability and retirement security—especially given that studies have shown that ESG proposals can detract from shareholder value.[3]

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[1] House Report No. 115-904, to accompany H.R. 5756. House Committee on Financial Services, 115th Congress, 2nd Session (24 August 2018).

[2] *National Compensation Survey: Employee Benefits* (May 2022). Bureau of Labor Statistics. *Available at* https://www.bls.gov/ebs/publications/september-2022-landing-page-employee-benefits-in-the-united-states-march-2022.htm.

[3] Joseph P. Kalt, L. Adel Turki et al., *Political, Social, and Environmental Shareholder Resolutions: Do They Create or Destroy Shareholder Value?* (June 2018). *Available at* https://documents.nam.org/tax/nam_shareholder_resolutions_study.pdf.

To be clear, manufacturers believe strongly in the importance of combatting climate change, ensuring sustainable business operations and enhancing diversity, equity and inclusion in the workforce.

- For example, a recent survey of senior manufacturing executives conducted by the Manufacturing Leadership Council, the NAM's digital transformation division, found that 90% of respondents believed that manufacturing has a special responsibility to society to become more sustainable.[4] And companies are putting this belief into action—manufacturing in the U.S. is cleaner and more sustainable today than at any other time in history due to a revolution in how manufacturers produce, use and recycle energy. Thanks to these improvements, the U.S. reduced the six most common air quality pollutants by 78% between 1970 and 2020.[5] Looking forward, 90% of manufacturers are focused on improving energy efficiency and reducing energy use, 85% have a company-wide strategy to address sustainability or have embedded sustainability into their business practices and 57% either have or are developing a net zero greenhouse gas emissions-reduction goal.[6]

- Similarly, a recent report by the Manufacturing Institute, the NAM's workforce development and education affiliate, showed that a majority of manufacturing leaders believe that efforts to enhance diversity, equity and inclusion are critical to attracting, retaining and developing talent.[7] Manufacturing leaders have also found that DEI efforts can increase productivity, ensure balanced organizational management and increase their competitive advantage.[8] These efforts are critical at a time when there are 604,000 open jobs in manufacturing waiting to be filled.[9]

In short, manufacturers are already taking steps to address these important issues in a way that is appropriate for their businesses—not because it might result in a high ESG rating from an activist group, but because it is the right thing to do for their workers, their shareholders and the U.S. economy as a whole. ESG activists and their allies have no such duty to everyday American investors, and so are free to pursue social and political outcomes divorced from the best interests of a business and its shareholders. Recent actions from the SEC have only served to further empower these groups.

Today's Subcommittee hearing on the proxy process thus comes at a critical time. Congressional action is needed to counter the outsized influence that politically motivated third-parties have on the proxy process and to depoliticize the business decisions that impact the lives and life savings of millions of Americans. Addressing these important issues will drive job-creating investments throughout the manufacturing industry, support a robust manufacturing supply chain in local communities across the country and bolster American manufacturing competitiveness on the world stage.

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[4] *Survey: Sustainability Momentum Surges Dramatically* (29 November 2022). Manufacturing Leadership Council. *Available at* https://www.manufacturingleadershipcouncil.com/survey-the-sustainability-shift-accelerates-31159/.

[5] *Our Nation's Air* (8 June 2020). Environmental Protection Agency. *Available a*t https://gispub.epa.gov/air/trendsreport/2020/#home.

[6] MLC Sustainability Survey, *supra* note 4.

[7] *Beyond reskilling: Manufacturing's future depends on diversity, equity, and inclusion* (4 May 2021). Deloitte and the Manufacturing Institute. *Available at* https://www.themanufacturinginstitute.org/wp-content/uploads/2021/05/us-dei-beyond-reskilling.pdf.

[8] *Ibid.*

[9] *Job openings levels and rates by industry and region, seasonally adjusted* (6 July 2023). Bureau of Labor Statistics. *Available at* https://www.bls.gov/news.release/jolts.t01.htm.

To ensure that manufacturers can focus on creating value for shareholders and driving economic expansion in the United States, the NAM is calling on Congress to:

1. Prevent activists from hijacking the proxy ballot in pursuit of agendas unrelated to long-term business growth and shareholder value creation;
2. Rein in proxy advisory firms and limit their outsized influence on corporate governance;
3. Reinforce asset managers' fiduciary duty to Main Street investors and retirees; and
4. Address the onslaught of ESG disclosure mandates by requiring public companies to report only that information which is material to their shareholders.

The NAM appreciates that the Subcommittee is considering legislation today that would accomplish these critical goals. Manufacturers are dedicated to protecting the Americans who have entrusted them with their hard-earned savings and who depend on those investments for their retirement and quality of life. The NAM looks forward to working with the Subcommittee to advance the following bills to rein in the SEC's regulatory overreach, keep activists out of the boardroom and protect Americans' investments in manufacturing growth.

I. Depoliticizing Corporate Governance

Modern portfolio theory, which prioritizes diversification to protect against downside risk, means that most Main Street investors hold shares in dozens if not hundreds of companies—whether individually or through investing vehicles like mutual funds. It is simply not practical for shareholders to be involved in the day-to-day operations of each of these companies. Instead, investors depend on corporate leadership to act in their long-term financial best interests by increasing the value of the business and thus enabling everyday Americans to save for retirement, a new home or a child's education.

The proxy ballot protects shareholders by granting them oversight of the company leaders who are charged with safeguarding their investments. But activist groups have hijacked the ballot in pursuit of political agendas unrelated to long-term business growth and shareholder value creation.

The NAM has long supported reforms to Rule 14a-8—which dictates which shareholder proposals companies must include on their proxy ballot—in order to protect the integrity of the proxy process and limit activists' influence. In 2020, manufacturers supported[10] an SEC rule to increase the share ownership thresholds under Rule 14a-8 that enable activists to take *de minimis* positions in a company's stock for the sole purpose of forcing the entire shareholder base to consider a politically motivated proposal.[11] The 2020 rule also increased Rule 14a-8's resubmission thresholds, which allow activists to place a proposal on the proxy ballot year after year, even when it has been resoundingly rejected by the vast majority of shareholders.

Unfortunately, the SEC recently has taken steps to undermine these critical reforms and to empower activists at the expense of public companies and their long-term shareholders. In 2021, the SEC's Division of Corporation Finance issued Staff Legal Bulletin 14L, which effectively prohibits companies from excluding from the proxy ballot any shareholder proposal related to environmental and social topics of "broad societal impact."[12] The 2020 rule was designed to prioritize the needs of

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[10] NAM Comments on Proposed Amendments to Rule 14a-8 (3 February 2020). *Available at* https://documents.nam.org/tax/namshareholderrulecomments.pdf.

[11] *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8*, 85 Fed. Reg. 214 (4 November 2020). Release No. 34-89964; *available at* https://www.govinfo.gov/content/pkg/FR-2020-11-04/pdf/2020-21580.pdf.

[12] *Staff Legal Bulletin No. 14L* (3 November 2021). SEC Division of Corporation Finance. *Available at* https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals.

long-term shareholders over the agendas of activist investors—but SLB 14L effectively grants activists special access to the proxy ballot to pursue ESG causes of their choosing. The NAM has said that SLB 14L will "incentiviz[e] shareholder proposals wholly unrelated to long-term shareholder value creation" and transform the proxy process "into an avenue for activists to apply pressure to companies on the political issues of the day."[13]

Similarly, in 2022 the SEC proposed a rule that would significantly narrow several of the so-called "exclusion criteria" under Rule 14a-8.[14] These criteria allow companies to exclude from the proxy ballot proposals that would divert time and resources by forcing shareholders to consider irrelevant, inappropriate, moot, duplicative or unlawful proposals. But the SEC's proposed rule is designed to make it more difficult for companies to exclude proposals that have already been substantially implemented by the company, are duplicative of other proposals on a given year's proxy ballot or have been rejected by a large percentage of the shareholder base in previous years—making it easier for activists to flood the proxy ballot with these substantially implemented, duplicative and resubmitted proposals.

Activists have received the SEC's message loud and clear. During the 2022 proxy season, shareholder proponents once again submitted a record-breaking number of proposals, continuing a persistent trend from the last several years.[15] Fully 60% of the proposals ultimately included on companies' proxy ballots involved environmental or social issues, an all-time high.[16] Environmental proposals were up 51% as compared to 2021, while lobbying and political spending proposals increased 36% and social proposals increased 20%.[17] And exempt solicitation filings, which allow activists to advocate for and draw publicity to their proposals, have increased by 70% since 2020.[18] These proposals come from a vanishingly small number of activists—just 10 proponents accounted for more than 60% of all proposals submitted in 2022[19]—yet these individuals' agendas force companies and their shareholders to expend significant resources and court controversy by wading into political topics unrelated to the business.

The SEC is increasingly a partner in these activists' efforts. When a company wishes to exclude a shareholder proposal under Rule 14a-8, it must first seek permission from the SEC through the Division of Corporation Finance's no-action process. In 2022, the success rate for these no-action requests plummeted: from 71% in 2021 to 38% in 2022.[20] In other words, companies are increasingly being forced to include politically motivated proposals on their proxy ballot, at significant expense—a trend that will likely persist as the SEC continues to implement SLB 14L and if it finalizes its proposed amendments to the Rule 14a-8 exclusion criteria.

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[13] NAM Comments on SLB 14L (30 November 2021). *Available at* https://documents.nam.org/tax/nam_comments_slb_14l.pdf.

[14] *Substantial Implementation, Duplication, and Resubmission of Shareholder Proposals Under Exchange Act Rule 14a-8*, 87 Fed. Reg. 45052 (27 July 2022). Release Nos. 34-95267, IC-34647; *available at* https://www.govinfo.gov/content/pkg/FR-2022-07-27/pdf/2022-15348.pdf.

[15] Rosati, Brigid, Kilian Moote et al., *A Look Back at the 2022 Proxy Season* (23 October 2022). Georgeson LLC. *Available at* https://corpgov.law.harvard.edu/2022/10/23/a-look-back-at-the-2022-proxy-season/.

[16] Copland, James R., *Proxy Monitor 2022 Voting Results: Mid-Season Review* (19 May 2022). Manhattan Institute. *Available at* https://www.manhattan-institute.org/proxy-monitor-2022-mid-season-review.

[17] *Shareholder Proposal Developments During the 2022 Proxy Season* (11 July 2022). Gibson, Dunn & Crutcher LLP. *Available at* https://www.gibsondunn.com/shareholder-proposal-developments-during-the-2022-proxy-season/.

[18] *Ibid.*

[19] *2022 Proxy Season Review: Part 1* (2 August 2022). Sullivan & Cromwell LLP. *Available at* https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/sc-publication-2022-Proxy-Season-Part-1-Rule-14a-8.pdf.

[20] Gibson Dunn 2022 Proxy Season Review, *supra* note 17.

This politicization of the proxy ballot is illustrative of the fundamental flaw at the heart of Rule 14a-8: the SEC lacks the statutory authority to require public companies to include shareholder proposals on their proxy ballots. Forcing companies to speak on these policy proposals and to subsidize activists' speech are clear violations of the First Amendment's prohibition on government-compelled speech. Rule 14a-8 outlines the circumstances in which "a company *must* include a shareholder's proposal in its proxy statement,"[21] and the SEC's no-action letters are the definitive authority as to whether a company can exclude a given proposal. Because Rule 14a-8 "plainly alters the content of [companies'] speech," it is "a content-based regulation of speech"[22]—especially given that publishing and speaking on activists' proxy ballot proposals is certainly not "limited to purely factual and uncontroversial information."[23, 24]

The NAM is encouraged that the Subcommittee is considering legislation to block activists and the SEC from politicizing the proxy process. Manufacturers support the following bills, which would keep activists out of the boardroom and enable companies and their shareholders to focus on issues that drive the long-term growth, job creation and innovation critical to America's competitiveness on the world stage and manufacturing workers' lives and careers here at home.

Rule 14a-8(i)(12) Resubmission Thresholds

Under Rule 14a-8, failed shareholder proposals must be included on the following year's proxy ballot if they have achieved a certain level of shareholder support. Proposals receiving as little as 5% support—which is to say, those opposed by 95% of shareholders—are guaranteed a place on a subsequent year's ballot despite overwhelming opposition from the shareholder base. This empowers activists pursuing niche agendas and the proxy advisory firms whose support for these proposals virtually guarantees they will exceed the necessary threshold for resubmission.

The NAM supports draft legislation that would increase the resubmission thresholds to require a more substantial level of shareholder support before allowing a failed proposal back on the proxy ballot. Specifically, to qualify for resubmission, a proposal would have to achieve 10% support if voted on once, 20% support if voted on twice or 40% support if voted on three or more times. These reforms would prevent companies from being forced to include on the proxy ballot proposals that have been rejected by an overwhelming majority of shareholders.

Rule 14a-8(i) Exclusion Criteria

In 2022, the SEC proposed a rule to narrow the exclusion criteria under Rule 14a-8. The SEC's proposed rule would make it more difficult for companies to exclude proposals that have already been substantially implemented, are duplicative of other proposals on a given year's proxy ballot or have been rejected by a large percentage of the shareholder base in previous years.

The NAM supports draft legislation that would block the SEC from finalizing its proposed rule. By preserving the existing exclusion criteria, the bill would make it more difficult for activists to flood the proxy ballot with substantially implemented, duplicative and resubmitted proposals.

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[21] 17 C.F.R. 240.14a-8 (emphasis added).

[22] *Nat'l Inst. of Fam. & Life Advocs. v. Becerra*, 138 S. Ct. 2361, 2371 (2018).

[23] *Id.* at 2372.

[24] The NAM recently intervened in litigation to show that the SEC's actions dictating the content of public company proxy ballots are unlawful. *See* Mtn. for Leave to Intervene, *National Center for Public Policy Research v. SEC*, No. 23-60230 (5th Cir.).

Exclusion of Politically Motivated Shareholder Proposals

The SEC lacks the statutory authority to force companies to include politically motivated shareholder proposals on their proxy ballots. But under SLB 14L the SEC has adopted the official policy that companies must always include proposals that raise issues of “broad societal impact,” even if those issues have no relationship to their operations.

The NAM supports draft legislation that would clarify that companies can always exclude shareholder proposals that seek to advance environmental, social and political agendas unrelated to their business. This change would ensure that the proxy ballot remains focused on issues that are relevant to long-term growth and shareholder value creation.

SLB 14L

Issued in November 2021, SLB 14L rescinded the SEC’s content-neutral guardrails that previously had enabled companies and investors to take a company-specific approach to evaluating the relevance and appropriateness of shareholder proposals submitted to company proxy ballots. In place of the rescinded standards, SLB 14L announced that the SEC would “no longer focus on determining the nexus between a policy issue and the company,” instead requiring all proposals with a “broad societal impact” to be included on the proxy ballot whenever submitted.

The NAM supports draft legislation that would revoke this damaging policy and allow companies to omit shareholder proposals based on the Rule 14a-8 exclusion criteria, irrespective of whether they relate to a significant social policy issue. SLB 14L has encouraged activists to submit and the SEC to endorse proposals wholly unrelated to long-term value creation, so this change would be a welcome return to a proxy process focused on business growth and investor value.

SEC Authority to Require Inclusion of Shareholder Proposals

The SEC’s policy of requiring the inclusion of certain shareholder proposals on public company proxy ballots is a clear violation of the First Amendment’s prohibition on government-compelled speech. It is unlawful for the federal government to force companies to speak on these politically motivated proposals and to require them to subsidize activists’ speech by publishing proposals in their proxy materials.

The NAM supports draft legislation that would prevent the SEC from compelling companies to include any shareholder proposal on their proxy ballots. In so doing, the bill would protect manufacturers’ First Amendment rights and prevent companies and their shareholders from being forced to consider irrelevant and politically motivated proposals on an annual basis.

SEC Study on the Proxy Process

The politicization of the proxy process impacts companies of all sizes, including small businesses. Growing companies often lack the resources to combat activist efforts. They may also be impacted when politically motivated proposals force larger businesses to commit to changes within their value chain that flow down to small and privately held suppliers and customers.

The NAM supports draft legislation that would require the SEC to conduct a comprehensive study on the proxy process. The study would examine the impacts of Rule 14a-8, the role of proxy advisory firms and the costs of politically motivated shareholder proposals. This is critical information necessary for Congress and the SEC to fully understand what changes are necessary to protect companies of all sizes from costly and undue influence.

II. Reining in Proxy Advisory Firms

Proxy advisory firms play a central role in the proxy process by providing voting research, recommendations and other services to institutional investors. Two firms—ISS and Glass Lewis—are estimated to control more than 97% of the proxy advice market. Yet as this duopoly's influence has increased in recent years, due in large part to the increase in institutional ownership of American stocks, the regulatory guardrails under which proxy firms operate have failed to keep pace. Until recently, there has been little-to-no regulation of these powerful entities and minimal accountability for their conflicts of interest, opaque methodologies, rigid and inflexible policies, propensity for errors and misleading statements and unwillingness to engage with publicly traded companies. For example:

- Proxy firms operate with undisclosed and unaddressed conflicts of interest. Of particular concern, ISS operates a consulting business that counsels companies on the very corporate governance policies on which the advisory side of the firm makes recommendations.

- Proxy firms insist upon a one-size-fits-all approach to corporate governance that does not take into account differences in companies' business models and the flexibility allowed under securities law. Increasingly, they also seek to shape rather than analyze and report on corporate behavior, particularly as it relates to ESG issues.

- The guidelines on which proxy firms based their recommendations, and the recommendations themselves, are developed with minimal transparency or stakeholder input. The lack of transparency associated with these quasi-regulatory standards is a significant contrast to the rigorous notice-and-comment procedures that the SEC and other regulators are required to follow.

- Proxy firm reports and recommendations feature a multitude of errors and misleading statements, ranging from specific incorrect facts to mistaken assumptions about, for instance, a company's peer group or compensation practices. The recommendations also feature terms with common market meanings like "total shareholder return" but often use opaque calculation methodologies that vary from traditional market practice.

- Proxy firms have been steadfastly resistant to engaging in a productive dialogue with issuers to correct errors and misunderstandings. Indeed, following the finalization of the SEC's 2020 proxy firm rule, ISS rescinded the limited issuer engagement practices it had previously had in place.

- Proxy firms often engage in the automatic submission of proxy votes on behalf of their clients in a practice known as "robo-voting." Robo-voting deprives asset managers—and by extension the Main Street investors they represent—of an opportunity to review a proxy firm's recommendation and make an informed voting decision.

In 2020, the SEC finalized a long-awaited rule to provide appropriate oversight of proxy advisory firms.[25] The 2020 rule, developed over the course of a decade, instituted commonsense safeguards designed to increase transparency into these powerful actors. In particular, the rule required proxy firms to provide copies of their final recommendations to companies and to have a mechanism in place by which investors could become aware if a company submitted a response to the firm's recommendation. It also required proxy firms to disclose their conflicts of interest and clarified that proxy firms are subject to the proxy solicitation rules' antifraud standards. Alongside the final rule, the

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[25] *Exemptions From the Proxy Rules for Proxy Voting Advice*, 85 Fed. Reg. 55082 (3 September 2020). Release No. 34-89372; *available at* https://www.govinfo.gov/content/pkg/FR-2020-09-03/pdf/2020-16337.pdf.

SEC issued guidance to asset managers outlining instances in which relying on proxy firms' robo-voting services instead of reviewing all information available to them and making an informed voting decision could implicate their fiduciary obligations to Main Street investors.[26]

Notably, the 2020 rule's issuer engagement requirements were significantly less strict than what the SEC had proposed in 2019.[27] The 2019 proposal would have required proxy firms to allow companies to review and provide feedback on their *draft* recommendations—a policy idea that dates back to at least the SEC's 2010 Concept Release on the U.S. Proxy System.[28] Proxy firms also would have been required to disseminate company responses to their clients alongside their voting advice. The NAM strongly supported, and continues to support, the draft review and feedback provisions from the 2019 proposal.

Despite the compromise approach adopted by the 2020 rule, in 2021 the SEC's new leadership began to take steps to dismantle this important progress. In a series of actions in June 2021, the SEC announced it would "revisit" the 2020 rule[29] and suspend enforcement of the rule;[30] the SEC also made clear to ISS in a court filing that the decision to suspend enforcement granted proxy firms "relief" from the rule's compliance requirements.[31] In a lawsuit brought by the NAM, a federal judge found that this suspension of the rule, which was effectuated absent the notice-and-comment proceedings required by the Administrative Procedure Act, was unlawful.[32]

In November 2021, the SEC proposed a rule to rescind critical provisions of the 2020 rule, including the compromise requirement that proxy firms share their recommendations with impacted companies after they are finalized and take steps to ensure that investors have access to any company responses to those recommendations.[33] The rescission, which manufacturers strongly opposed,[34] was finalized in July 2022.[35] Concomitant with the rescission of the 2020 rule, the SEC also rescinded the 2020 robo-voting guidance.

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[26] *Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, 85 Fed. Reg. 55155 (3 September 2020). Release No. IA-5547; *available at* https://www.govinfo.gov/content/pkg/FR-2020-09-03/pdf/2020-16338.pdf.

[27] *See Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice*, 84 Fed. Reg. 66518 (4 December 2019). Release No. 34-87457; *available at* https://www.govinfo.gov/content/pkg/FR-2019-12-04/pdf/2019-24475.pdf.

[28] *See Concept Release on the U.S. Proxy System*, 75 Fed. Reg. 42982 (22 July 2010). Release Nos. 34-62495; IA-3052; IC-29340, *available at* https://www.govinfo.gov/content/pkg/FR-2010-07-22/pdf/2010-17615.pdf. For instance, the Concept Release observes that proxy firms "may be unwilling, as a matter of policy, to accept any attempted communication from the issuer or to reconsider recommendations in light of such communications" and notes that "issuers have expressed a desire to be involved in reviewing a draft of the proxy advisory firm's report, if only for the limited purpose of ensuring that the voting recommendations are based on accurate issuer data" (at 43012).

[29] *Statement on the Application of the Proxy Rules to Proxy Voting Advice* (1 June 2021). Chairman Gary Gensler. *Available at* https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01.

[30] *Statement on Compliance with the Commission's 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9.* SEC Division of Corporation Finance (1 June 2021). *Available at* https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01.

[31] *See* Mtn. for Abeyance, *Institutional Shareholder Services Inc. v. SEC*, No. 19-cv-3275 (D.D.C.). The NAM is an intervenor-defendant in this case.

[32] *See Nat'l Ass'n of Mfrs. v. SEC*, 2022 WL 16727731 (W.D. Tex. 2022).

[33] *Proxy Voting Advice*, 86 Fed. Reg. 67383 (26 November 2021). Release No. 34-93595; *available at* https://www.govinfo.gov/content/pkg/FR-2021-11-26/pdf/2021-25420.pdf.

[34] NAM Comments on Proxy Firm Rescission Rule (24 December 2021). *Available at* https://documents.nam.org/tax/nam_proxy_comments_2021.pdf.

[35] *Proxy Voting Advice*, 87 Fed. Reg 43168 (19 July 2022). Release Nos. 34-95266, IA-6068; *available at* https://www.govinfo.gov/content/pkg/FR-2022-07-19/pdf/2022-15311.pdf.

The rescission was effectuated via an abbreviated notice-and-comment process that SEC Commissioner Mark Uyeda described as a "regulatory seesaw" that "does not reflect administrative 'best practices' that promote long term reliance and confidence by market participants in the stability of important areas of securities regulation."[36] At no point during this truncated rulemaking did the SEC provide any reasonable justification for why the same record that supported the 2020 rule two years prior suddenly required its rescission, in clear violation of the APA.[37]

Given proxy firms' continued outsized influence on corporate governance at manufacturers of all sizes—and the SEC's ongoing efforts to deregulate these powerful actors—congressional action is clearly needed. The NAM appreciates that the Subcommittee is considering legislation to rein in proxy advisory firms. Manufacturers support the following bills, which would address proxy firms' significant conflicts of interest and minimal accountability and transparency.

Proxy Firm Registration

Given the SEC's rescission of much of its 2020 proxy firm rule, more must be done to provide appropriate regulatory oversight of proxy firms. In particular, the NAM supports efforts to require proxy firms to offer companies an opportunity to review and provide feedback on draft recommendations, ensure that investors have access to company responses and prevent proxy firms from distorting company decisions and investor votes by offering consulting services to the same companies whose governance is the subject of their voting advice.

The NAM supports draft legislation, sponsored by Rep. Bryan Steil (R-WI), that would require proxy firms to register with the SEC. As a condition of registration, proxy firms would be required to:

- Provide companies with the data and information underpinning their recommendations, and grant companies an opportunity to share feedback to correct errors and misrepresentations;
- Employ an ombudsman charged with engaging with companies and resolving issues identified by impacted businesses;
- Include any company statements responding to the firm's recommendations in its final report to clients;
- Certify that the firm has sufficient staff and resources to provide voting advice based on accurate information and in the economic best interests of shareholders;
- Provide disclosures on the firm's procedures, methodologies, organizational structure, professional qualifications and code of ethics; and
- Adopt policies to identify, disclose and manage any conflicts of interest.

Additionally, proxy firms would be prohibited from providing advisory or consulting services that present a conflict of interest with respect to their recommendations.

These reforms will improve the quality, accuracy and reliability of proxy voting advice, and they are essential to countering the threat that proxy firms' outsized influence poses to everyday Americans' retirement savings. The NAM applauds Rep. Steil for his years of leadership on this critical issue, and manufacturers strongly support his draft legislation to bring appropriate oversight to the proxy advice industry.

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[36] *Statement on Final Rule Amendments on Proxy Voting Advice* (13 July 2022). Commissioner Mark Uyeda. *Available at* https://www.sec.gov/news/statement/uyeda-statement-amendments-proxy-voting-advice-071322.

[37] The NAM's lawsuit challenging the rescission as unlawful under the APA is currently pending before the Fifth Circuit Court of Appeals. *See Nat'l Ass'n of Mfrs. v. SEC,* No. 7:22-cv-163-DC (5th Cir.).

Proxy Firm Antifraud Liability

The 2020 proxy firm rule clarified that proxy voting advice constitutes a solicitation under the Exchange Act, subjecting proxy firms to the proxy solicitation rules, including those rules' antifraud standards. Specifically, the 2020 rule noted that proxy firms may need to provide appropriate disclosures with respect to their methodologies, sources of information and conflicts of interest in order to ensure that their advice is not false or misleading.

In rescinding much of the 2020 rule, the SEC in 2022 removed the language that had been added to the antifraud standards about proxy firms' methodologies, sources of information and conflicts of interest. While proxy firms are still subject to antifraud liability under the rescission, the standards under which that liability may apply have been significantly weakened.

The NAM supports draft legislation, sponsored by Rep. Steil, that would clarify that the failure to disclose material information associated with proxy voting advice, such as information about a proxy firm's methodologies, sources of information and conflicts of interest, would render the advice false or misleading. This change is critical to ensuring that proxy firm clients have access to the material information they need to make fully informed voting decisions.

III. Protecting Main Street Investors

Most Americans' primary exposure to the stock market is through passive investing vehicles like mutual funds, pension plans and 401(k) accounts. These funds allow Main Street investors to share in manufacturing's success and set the stage for financial security for American families. The day-to-day operations of these funds, including asset allocation and proxy voting, are overseen by fund or plan managers employed by large institutional investors. These institutions have a fiduciary duty to the underlying beneficial owner of the securities the fund holds: everyday Americans saving for a new home, a child's education or a secure retirement. Fund managers are legally obligated to act in these investors' financial best interests.

As public company governance has become increasingly politicized in recent years, questions have arisen about the proper role and responsibilities of the asset managers charged with protecting Main Street investors' holdings. Many institutional investors over-rely on the recommendations of proxy advisory firms, for example. A 2018 study found that 175 institutions, with more than $5 trillion in assets under management, voted in lock step with proxy firms more than 95% of the time.[38] This outsourcing of important proxy voting decisions has been further enabled by the SEC's rescission of its 2020 robo-voting guidance.

More broadly, some asset managers may be prioritizing goals unrelated to shareholder value creation by making asset allocation and proxy voting decisions based on ESG criteria, and many Main Street investors are unaware that these decisions could increase their risks or reduce their returns. For example, many asset managers allocate funds or cast proxy votes based on grades published by ESG ratings organizations, despite these groups' lack of transparency, consistency or engagement with companies—and their stated goal of achieving social policy outcomes rather than enhancing shareholder value.

The NAM is encouraged that the Subcommittee is considering legislation to ensure that Wall Street fund managers are acting in the best interests of manufacturing workers and other Main Street investors. Manufacturers support the following bills, which would limit robo-voting, prevent asset

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[38] Doyle, Timothy M., *The Realities of Robo-Voting* (9 November 2018). American Council for Capital Formation. *Available at* https://accfcorpgov.org/wp-content/uploads/ACCF-RoboVoting-Report_11_8_FINAL.pdf.

managers from over-relying on proxy firms and protect the long-term financial best interests of everyday Americans.

Asset Manager Reliance on Proxy Firm Recommendations

Despite their fiduciary duty to Main Street investors and retirees, some asset managers are over-relying on the ratings and recommendations of proxy firms and ESG ratings organizations and may be making proxy voting decisions based on criteria divorced from shareholders' financial best interests.

The NAM supports draft legislation that would require investment advisers, asset managers and pension funds relying on the services of a proxy firm to explain how the firm's recommendations impacted their proxy votes, analyze their voting decisions based on investors' economic best interests and the institution's fiduciary duty and disclose the degree to which the institution voted in line with the firm's recommendations. These institutions would also be required to certify that their voting decisions were made based solely on the economic best interests of their customers and beneficiaries.

These safeguards would ensure that the institutions charged with protecting Main Street investors' retirement security are acting in those investors' best interests. They would also give everyday Americans the information they need to make decisions about how their savings are managed.

Robo-Voting

Robo-voting allows proxy firms to automatically cast votes on their clients' behalf—in line with the proxy firm's recommendations and without any review by the asset manager. As former SEC Commissioner Elad Roisman has noted, these "set-it-and-forget-it" mechanisms are generally not well understood by the investors whose shares are being voted, nor are they always consistent with an investment adviser's fiduciary duties.[39]

The NAM supports draft legislation that would prevent institutional investors from outsourcing proxy voting decisions to proxy advisory firms via the firms' robo-voting services. This prohibition on robo-voting would ensure that asset managers actually review the information available to them before casting proxy votes that could impact the direction of a business and the performance of everyday Americans' investments.

Proxy Voting by Passively Managed Funds

Many Americans participate in passively managed funds, which are designed to track a certain set of companies within an industry or the economy writ large. For example, most institutions offer a version of an S&P 500 fund, which simply holds shares proportionally of every company in the S&P 500 index. As new companies are added to or dropped from the index, or their relative size increases or decreases, the fund will make asset allocation changes accordingly. The managers of these funds do not exercise any independent judgment with respect to its holdings; they simply track the index. But, in some cases, these *passive* managers have taken an *active* role in companies' corporate governance by leveraging the fund's holdings via proxy votes.

The NAM supports draft legislation that would require managers of passive funds to stay passive—which is to say, to defer to the judgment of companies' boards of directors and to rely on those directors' fiduciary duty to shareholders. Unless instructed otherwise by their clients, passive funds

[39] *Speech at the Council of Institutional Investors' Conference* (10 March 2020). Commissioner Elad L. Roisman. *Available at* https://www.sec.gov/news/speech/speech-roisman-cii-2020-03-10.

would be required to vote in alignment with a company's voting recommendations on most proxy ballot measures, with exceptions for issues like director elections and executive compensation. Passive funds could also choose to abstain from voting. These reforms would ensure that fund managers are appropriately representing the Main Street investors who have chosen to participate in a passive fund.

IV. Limiting ESG Disclosure Mandates

Over the past two years, the SEC has expanded its regulatory ambit into policy areas not traditionally subject to Commission action. In particular, the SEC's focus on ESG issues has undermined the long-settled materiality standard governing public company disclosure obligations. This departure from materiality has in many instances led to disclosure requirements justified solely by policy concerns outside the SEC's purview, a concerning trend for an agency whose disclosure rules should be designed to protect investors and facilitate capital formation.

The SEC is legally constrained by the confines of its statutory authority,[40] and that authority is centered on facilitating the provision of material information for the protection of investors. As recently as 2016, the SEC itself made clear that "disclosure relating to environmental and other matters of social concern should not be required of all registrants unless appropriate to further a specific congressional mandate or unless, under the particular facts and circumstances, such matters are material."[41] To the extent that the SEC's proposed ESG reporting requirements exceed material disclosures necessary for a reasonable investor to understand the total mix of information available about an issuer and to make a corresponding investing decision, they are unlawful.[42]

For instance, in March 2022 the SEC proposed a novel, one-size-fits-all climate reporting mandate that would impose tremendous costs on all public companies, as well as on the private businesses within their supply chains.[43] Manufacturers are dedicated to combatting climate change and to providing appropriate disclosures about these efforts, but the SEC's proposed rule would require reporting far in excess of the material information necessary for investors to make informed decisions. In response to the proposed rule, the NAM expressed concern that it would "institute[ ] a wide-ranging mandate for public companies to generate and report pages upon pages of information, much of which is not material to their operations or financial performance," ultimately resulting in "substantially increase[d] compliance costs and legal risks for public companies—despite limited investor benefit."[44]

A centerpiece of the proposed climate disclosures rule is its mandate that public companies report their so-called "Scope 3" emissions: those attributable to the suppliers and customers within their value chains. This requirement will expose public companies, as well as a wide range of small and

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[40] *See, e.g., Global Tel*Link v. FCC*, 866 F.3d 397, 412 (D.C. Cir. 2017) (vacating an FCC regulation as "beyond the statutory authority of the Commission" where the agency acted to further a "desirable social policy" while ignoring statutory limits).

[41] *Business and Financial Disclosure Required by Regulation S-K*, 81 Fed. Reg. 23916 (22 April 2016). Release Nos. 33-10064, 34-77599; *available at* https://www.govinfo.gov/content/pkg/FR-2016-04-22/pdf/2016-09056.pdf.

[42] *See Utility Air Regulatory Grp. v. EPA*, 573 U.S. 302, 314–316 (2014) (noting that courts routinely hold unlawful agency action in violation of statutory limits on agencies' authority); *see also Reuters Ltd. v. FCC*, 781 F.2d 946, 95 (D.C. Cir. 1986) (explaining that an agency may not "deviate from its rules in order to achieve what it deems to be justice").

[43] *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 Fed. Reg. 21334 (11 April 2022). Release Nos. 33-11042, 33-94478; *available at* https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf.

[44] NAM Comments on Proposed Climate Disclosures Rule (6 June 2022). *Available at* https://documents.nam.org/tax/nam_comments_sec_climate_rule.pdf.

privately held businesses, to a costly reporting burden that in many instances will prove infeasible or impossible given the uncertain nature of Scope 3 tracking and estimation methodologies. But Scope 3 emissions data is unlikely to be material to a shareholder's investing decisions, especially as Scope 3 reporting methodologies continue to evolve. Lacking a robust link to shareholder value creation, the Scope 3 mandate, like many other provisions in the climate rule, represents the SEC pursuing substantive outcomes with respect to major questions about climate policy.

The climate rule is just one example of the SEC's regulatory overreach. Other rulemakings, such as the proposed cybersecurity disclosures rule and the recently finalized stock buybacks disclosures rule, similarly impose immaterial disclosure mandates on public companies. And the SEC has announced that it plans to propose a human capital management rule later this year, replacing the Commission's existing human capital reporting requirement—which requires disclosure only of material human capital measures or objectives—with something more expansive. These new mandates are illustrative of the costly and burdensome regulatory onslaught manufacturers are currently experiencing at the hands of the federal government.

International financial regulators are also taking steps to increase corporate disclosure obligations beyond the material information that investors need. The European Union's Corporate Sustainability Reporting Directive is based on the concept of "double materiality," requiring disclosure of information necessary to understand a business's sustainability impact, not its financial performance. And the EU's Corporate Sustainability Due Diligence Directive would go even further, requiring companies to take steps to identify and mitigate certain environmental and social impacts throughout their value chains.

The NAM appreciates that the Subcommittee is considering legislation to rein in this onslaught and block ESG disclosure mandates that require reporting beyond material information. Manufacturers support the following bills, which would prevent regulators from increasing costs and liability for manufacturers and overwhelming investors with a deluge of irrelevant information.

Mandatory Materiality Requirement Act

The Supreme Court has held that information is only material if there is 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."[45] Investors are not unanimous in what, if any, climate and ESG metrics they would like to see from public companies, so the materiality standard's emphasis on the *reasonable* investor focuses public company disclosures on metrics that actually drive value creation and long-term shareholder return. Unfortunately, the SEC's proposed ESG mandates would require disclosures in excess of this time-tested and well-understood standard.

The NAM supports the Mandatory Materiality Requirement Act, which would allow the SEC to require disclosure only of information that is material to a shareholder's voting or investment decision pursuant to the Supreme Court's materiality definition. Limiting the SEC's authority to mandate immaterial disclosures would reduce costs for public companies while also ensuring that their reports are useful to investors.

SEC Justification of Non-Material Disclosure Requirements

The SEC's regulatory onslaught has resulted in disclosure obligations for public companies that are not grounded in materiality. The NAM supports draft legislation that would require the SEC to maintain a list of non-material disclosure requirements and provide a justification for why each

[45] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976); *see also Basic, Inc. vs. Levinson*, 485 U.S. 224 (1988).

disclosure is necessary. It would also clarify that a company choosing not to disclose non-material information would not be subject to a private right of action. These reforms would limit non-material disclosure obligations and protect companies from the increased liability that often flows from such requirements.

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On behalf of the NAM and the millions of people who make things in America, I appreciate the opportunity to testify before the Subcommittee today. Congressional action is needed to institute appropriate guardrails for the proxy process that will counter the SEC's regulatory overreach and depoliticize the business decisions that impact the lives and life savings of millions of Americans. The NAM looks forward to working with the Subcommittee to advance policies that preserve the public market as an avenue to capital formation for manufacturers—allowing our industry to create jobs, lead the economy and improve the quality of life for all Americans.