April 24, 2017

Office of Congressman Stephen Lynch
One Harbor St
Suite 304
Boston, MA 02210

Via email: jaclyn.cahan@mail.house.gov

Dear Representative Lynch:

I am writing in response to aspects of the discussion draft legislation that the House Financial Services Committee will consider during the April 26 hearing on the **Financial Choice Act**. I am concerned about multiple aspects of the bill that would affect our work as investors and fiduciaries, but I am writing to draw your attention to the provisions of **Section 844**, which would effectively eliminate fundamental rights of investors to file shareholder proposals. As a committee member, I am urging you to defend the rights of investors by **opposing any attempt to modify or limit the Securities and Exchange Commission's shareholder proposal rule, SEC Rule 14a-8**.

My firm, NorthStar Asset Management, Inc., is a Boston-based socially responsible investment firm. We manage assets of high net worth individuals and families as well as nonprofit organizations with the common goal of values-aligned investing. Clients join our firm because of our in-depth social screening policy, but also because we actively file shareholder resolutions. It is the fiduciary duty of our firm to engage with corporations on behalf of our clients regarding issues and social concerns that matter to our clients. We invest in high quality government bonds and community loan funds, but our primary investments are publicly-traded domestic and international equities.

Research has shown that company managers unchecked by shareholder input leads to poor performance over the long-term.[1] It is our responsibility to our clients, who often own only a few thousand dollars each in a particular company, to engage companies via the shareholder proposal process in order to protect their investments.

[1]"The Effects of Dual-class Ownership on Ordinary Shareholders." Knowledge@Wharton. 30 June 2004. <http://knowledge.wharton.upenn.edu/article/the-effects-of-dual-class-ownership-on-ordinary-shareholders/>

The effect of the proposed **Financial Choice Act** would be to eliminate the ability of shareholders, including our clients, to engage with companies and fellow investors on essential matters of corporate governance and risk management. The proposed legislation would:

**1. Alter the threshold for filing proposals to an impossible level so that only the very wealthiest investors could file proposals.** Should the legislation pass, in order to file a proposal, one would be required to hold 1% of shares over a three year period. In contrast, the longstanding current and well-functioning rule allows shareholders holding $2,000 for one year to file shareholder proposals. While updating this threshold to account for inflation could be reasonable, the draft legislation eliminates this fundamental shareholder right.

Smaller shareholders, whether individuals or institutional investors, would be cut out of this process entirely, even though they have been among the most important filers in the process. Depending on the size of the company, the holdings required by the proposed threshold would be in the millions or even billions of dollars, cutting out all but the largest shareholders from access to corporate democracy.

The shareholder proposal rule was created to support the ownership interests of <u>all</u> shareholders. The process gives us an essential tool to engage with boards and management on risk and governance concerns, and then if necessary, to spur debate among shareholders.

The quality of ideas in shareholder proposals, and their ultimate contribution to shareholder value, does not correlate with the size of the stock positions held by proponents. Experience shows that in the absence of the right to file a shareholder proposal, most shareholders may be ignored, and companies will act as if they are "too big to listen."

**2. Alter the <u>resubmission</u> threshold for proposals.** Current rules require that for a proposal to be resubmitted a subsequent year it must receive at least 3% support on its first year voted, 6% of the second, and 10% for each subsequent year. The draft legislation would raise these to 6%, 15%, and 30%, respectively. Yet support growing to 10% over 3 years is already proven to be a significant show of investor interest. For emerging issues and risks, the existing thresholds represent a significant growth in investor interest to merit continued discussion and disclosure on an issue.

In recent years, we have seen how directors and executives can become insular, engage in self-dealing or fraud, or simply fail to see risks and opportunities for profitability emerging outside of the board room. Ongoing deliberation and input from investors has been crucial to educating shareholders and boards over time and eventually arriving at effective governance and closer attention to social and environmental risks. These improve companies' financial performance.

**3. Prohibit filing on behalf of another person.** Currently it is common practice and well-functioning for investment advisors to file proposals on behalf of their clients. The legislation seeks to eliminate this traditional practice, undermining a right of state law to appoint an agent on one's behalf.

The shareholder proposal rule allows us to work on behalf of our clients to defend their interests by aiding them in raising risk and governance issues at their companies, and to suggest needed innovations and reforms. Moreover, our firm is often asked by our clients to file proposals on their behalf. They count on our expertise to navigate the complex rules of the SEC. As investment advisors, we act as agents for our clients in filing proposals. Our right to file such proposals exists under state law. The provision to prevent "filing by proxy" apparently attempts to preempt this existing state law right, and is inappropriate. The proposed changes through the Financial Choice Act would eliminate our ability to do so.

Investment advisors, trustees and fiduciaries have a duty to monitor risk; many of us extend that duty to filing proposals, when needed, to improve performance or manage those risks. Our risk controls also often prevent us from owning too great a stake in any single company, which, again, would mean that with the proposed changes, most shareholders with appropriate risk controls would lose any real potential for engagement, which the proposal process enables.

Please oppose these radical changes. The proposal process is working and does not need fixes.

The legislation would upset 70 years of SEC rulemaking and deliberations on this important and well-functioning corporate democracy process. This existing balance of rights and responsibilities in our investments supports a relationship of trust between capital providers and corporations. Stripping away shareholder rights as proposed by Chairman Hensarling would undermine that relationship. If Congress proves willing to alter rights associated with share ownership, it could undermine investor confidence in the inviolate rights of share ownership and discourage capital investment.

I have attached a background document on this issue for your convenience, and I would be glad to assist you or your staff further in preparing for Wednesday's hearing. In any event, **I urge you to oppose section 844 in Chairman Hensarling's proposed Financial Choice Act** discussion draft that attempts to limit shareholders' property rights.

Feel free to contact me via email at jgoodridge@northstarasset.com and/or my staff member Mari Schwartzer at mschwartzer@northstarasset.com.

Sincerely,

Julie N.W. Goodridge
CEO
NorthStar Asset Management, Inc.

**Discussion Draft – Financial CHOICE Act of 2017**
**Section 844: Shareholder Proposals**

## Our Position

While we have serious concerns about many elements of the Financial CHOICE discussion draft circulated by House Financial Services Chairman Jeb Hensarling and supported by corporate advocates such as the Business Roundtable and the U.S. Chamber of Commerce – this background memo focuses on our opposition to the proposals contained within Section 844, which relate to shareholder proposals. This memo provides (I) a short description of the shareholder proposal process and its history, (II) a description of current law, (III) a description of the proposed changes, and (IV) a discussion of why the proposed changes are bad policy and should be rejected by Congress.

## I. Brief Background on Shareholder Proposals

In the aftermath of the Great Depression, Congress tasked the SEC with creating a system to protect investors by balancing the interests of those who own financial stakes in a publicly listed company (shareholders) and those who run the business. Part of the answer was a system where shareholders could file recommendations (also referred to as "proposals" or "resolutions") relevant to the company to be published on the company's annual proxy statement, for a vote by all its shareholders.

## II. Current Law

The shareholder proposal process, set forth in SEC Rule 14a-8, specifies certain parameters around which shareholders can file resolutions:

1. In order to be eligible to submit a proposal, an investor must have continuously held at least $2,000 in market value, or 1% (whichever is lower), of the company's securities for at least one year by the date he or she submits a proposal. Investors must continue to hold those securities through the date of the annual meeting where proposals usually receive a vote.

2. In order for investors to resubmit the same proposal in successive years, their proposal must garner an increasing percentage of affirmative votes. In year 1 the threshold is 3%, in year two it is 6%, and year three it is 10%.

3. In addition, pursuant to state law of agency and contracts, of agency, shareholders often authorize investment advisors or experts to file shareholder resolutions on their behalf.

## III. Proposed Changes to Current Law in Financial CHOICE Act of 2017

This bill would change existing law to:

1. Require a 1% ownership (of total market capitalization) over a three-year period in order to be eligible to submit a proposal.

2. Increase resubmission thresholds to 6% of the vote in year 1 (from 3%); 15% in year 2 (from 6%); and 30% in year 3 (from 10%).

3. Prohibit the submission of proposals on behalf of a shareholder (what the bill refers to as "filing by proxy")

**IV. Why the Proposed Changes Are Bad Policy and Should Be Rejected**
Section 844 of the Financial CHOICE Act of 2017 is a clear overreach, representing radical and dramatic interference with important shareholder rights:

1. *1% ownership requirement over a three-year period:* This would require, for example, an investor in Wells Fargo to own $2.5 billion in shares in order to file a proposal. Only 11 investors have held those shares long enough: Berkshire Hathaway, Vanguard, BlackRock, Fidelity, Capital Research & Management, Wellington, JPMorgan, Dodge & Cox, Northern Trust, and State Street. Those investors do not file shareholder proposals at all, let alone shareholder proposals that have been filed at Wells Fargo on matters such as customer fraud, independent board chairman, proxy access, and irregularities in mortgage practices. The language in the discussion draft effectively kills any ability of shareholders to file proposals on these important issues. Improvements in business are driven by the marketplace of ideas, and minority shareholders are also important stakeholders.

2. *Increase resubmission thresholds*: This would mean resubmission thresholds of 6% (year 1, from 3%); 15% (year 2, from 6%); and 30% (year 3, from 10%). From 2007 through 2009 only about 17 percent of the proposals that came to a vote achieved the support of 30 percent of the shares voted, and from 2010 onwards, this has been approximately 30 percent of proposals filed.[1] This amendment would negatively impact shareholder re-filing of proposals on new and emerging issues. Change does not come quickly to large and complex corporations, and ideas often require years of consideration before they are accepted. Take for example the issue of declassified boards where directors stand for election each year – support of shareholder proposals on this issue was regularly below 10% in 1987 and below 30% for many years, but eventually grew to 81% in 2012. With 15% and 30% resubmission thresholds these proposals would have died long before they had the chance to be adopted. Declassified boards are now common practice, with two-thirds of S&P 500 companies holding annual votes, up from 40% 10 years ago.

3. *Prohibit proposal by a proxy other than the shareholder:* Investors have a fundamental right under state law to empower their representatives to act

[1] Report on US Sustainable, Responsible and Impact Investing Trends, 2017 - http://www.ussif.org/trends

on their behalf. Interference with these rights undermines this well functioning mechanism of corporate governance and investor relationships with corporate governance experts and financial advisor.

To learn more about this issue, please see a letter from organizations representing $65 trillion in opposition to these proposals and an in-depth briefing document.

**Additional Background**

The SEC has clear rules that allow companies to exclude improper shareholder resolutions, for instance, if they micromanage the company, address an immaterial portion of the company's operations, or violate state law. The staff of the SEC considers the arguments put forth by companies on the SEC guidelines that seek to exclude shareholder proposals based on the rules by issuing "no-action letters."

This system has worked well to balance interests and make sure that both company directors and investors don't go too far afield pursuing their own interests to the detriment of the other. Over the years it has helped shape corporate boards as independent, diverse, and elected annually, and safeguard against emerging risks – such as throughout supply chains and those posed by climate.

The process represents a cost effective way for corporate management and boards of directors to gain a better understanding of shareholder priorities and concerns and to benefit from those insights on critical and emerging risks and opportunities. The process has proven to be valuable to numerous companies and has given shareholders an important voice, consistent with the American tradition democratic governance and market based solutions.

**These resolutions are not a burden on the business community.** Most companies have never received a shareholder resolution and fewer than 1,000 resolutions are filed in an average year. After withdrawal of resolutions based on positive agreements (an average 25% of the resolutions submitted) or the SEC allowing a resolution to be omitted, there are closer to an average of 600 resolutions on environmental, social and governance issues going to a vote.

For example, in 2016 there were 382 social and environmental resolutions filed but only 203 went to a vote (USSIF 2016 Trends Report).

Sponsors of such resolutions range from individuals, to state and city pension funds, to foundations, investment firms, and mutual funds, trade union funds, religious investors – a broad cross-section of investors. **Pension funds and investment managers are, at least in part, motivated by their fiduciary duty to protect investors' interests.**

Finally, many investors do not exercise the right to file resolutions but do vote their proxies conscientiously. Thus the shareholder resolution becomes a platform for investors to communicate with a company by voting for or against a resolution.

Examples of mainstream mutual funds and investment managers voting stock include State Street, Northern Trust, Morgan Stanley, Goldman Sachs and John Hancock.

Eliminating the right to file resolutions takes away the opportunity for investors, large and small, to register a position with the company.

And finally there is ample evidence that the filing of shareholder resolutions has resulted in meaningful changes in company policies and practices.

Shareholder resolutions:

- Stimulated changes in governance, such as annual election of Directors, access to the proxy, majority vote for Directors;
- Since 2009, close to 100 companies have agreed to publish Sustainability Reports for investors in response to shareholder resolutions;
- Numerous companies have broadened their search for diversity on their Board and added women or people of color in response to shareowner engagements. Dozens of companies have committed to increasing diversity on the board of directors, thereby moving towards gender equity in the boardroom and encouraging companies to "open the pipeline" for woman and minorities to be promoted within companies;
- Over 150 companies are committed to disclosure and Board oversight of political spending in response to shareowner petition;
- Hundreds of companies have disclosed information and confirmed plans for reducing their Greenhouse Gas emissions in response to shareholder dialogue and resolutions.

Shareholder Proposals as Consumer Protection

The shareholder proposal process is relevant to most Americans because most Americans own stock in their savings, or indirectly benefit from their growth in their pensions. Over 55% of Americans directly own stocks – many of those are in 401K and retirement plans. That number was at 62% in 2008 (Gallup Poll, from 2015).[2]

A Goldman Sachs Report from 2013 found that "households directly own 38 percent of the US equity market. However, the total effective household ownership is closer to 80 percent when combined with indirect ownership in the form of mutual funds (20 percent), pension funds (16 percent), and insurance policy holdings (7 percent).[3]

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[2] http://www.gallup.com/poll/182816/little-change-percentage-americans-invested-market.aspx
[3] http://www.businessinsider.com/chart-stock-market-ownership-2013-3