

Proxy access at US companies

Position paper

Norges Bank Investment Management position

1. We support proxy access rights at US listed companies when applied with reasonable thresholds that enable shareholders to utilise the rights effectively.
2. We support the introduction of holding periods of up to three years and holding requirements of up to three percent.
3. We will accept a limit on the number of board seats to be affected by proxy access candidates if at least two seats or 20 percent of the board can be filled by such candidates.

Background

Proxy access refers to the formal right of shareholders to propose their own director candidates alongside the candidates nominated by the incumbent board. Both sets of candidates appear on the proxy ballot that is distributed to shareholders by the company at its expense.

It is the case today that neither US state nor federal law provide shareholders with proxy access rights. The Securities and Exchange Commission (SEC) proposed a universal rule on proxy access in 2010 but it was struck down by the US Court of Appeals for the District of Columbia Circuit. In the absence of a universal rule, the only recourse for shareholders to secure proxy access is to seek bylaw amendments company by company.

The relevance of proxy access to firm value and long-term investment returns is being analysed by a growing body of empirical literature. Among recent studies, the CFA Institute, *Proxy Access in the United States: Revisiting the Proposed SEC Rule (2014)* provides a literature review of event studies on the enacted SEC rule and the subsequent overturning. It concludes that proxy access would both benefit the financial markets and enhance board performance.

Arguments for the position

Provides shareholders with a reasonable right to propose board candidates

US state laws provide shareholders of US companies with a right to propose director candidates in competition with the candidates nominated by the incumbent board. However, there are considerable legal and cost impediments attached. For instance, the proponent must finance the distribution of alternative documentation to shareholders. Consequently, the right is rarely used. Proxy access provides shareholders with a reasonable ability to propose board candidates that should enhance democratic election procedures.

Provides greater director and board accountability

Shareholders' right to propose board candidates is a fundamental principle of good corporate governance and board accountability. A balance of power between shareholders, board of directors and company management is essential to a well-functioning corporate governance system. The existence of a proxy access right set on reasonable terms may be an effective way to enhance the responsiveness of boards to the interests of shareholders. Proxy access should increase the accountability of boards and encourage constructive engagement between shareholders and the board.

Provides a safeguard when boards fail

Proxy access provides shareholders with a secured route to change an incumbent board if it fails to improve poor governance or financial performance. Proxy access, if provided by bylaw right, is a legitimate route for an investor to initiate board change.

Arguments against the position

Introduces additional costs and unnecessary distraction

The lowered costs of proposing candidates can likely lead to a higher number of board contests and consequently more distraction and extra costs on companies in campaigning against the alternative candidates.

Serves special and short-term interests

Shareholders may use proxy access rights to serve short-term or special interests. Such use will increase the pressure on corporations to produce short-term returns at the expense of long-term value creation.

The board is best placed to determine board composition

Shareholder-initiated candidates may ignore the importance of board composition in terms of director qualifications and experience. The incumbent board and its nominating committee is considered better equipped to evaluate candidates, assess the balance of the board and ensure compliance with regulations. An unplanned change in the composition of the board could impair delivery of agreed strategy.

Norges Bank Investment Management considerations

In weighing these arguments, we consider the likely long-term advantages of proxy access more than compensate for the potential weaknesses. We place due weight on the consideration process of the SEC when concluding that the benefits of proxy access outweigh the disadvantages.

We see little evidence to support the concern that shareholders will use proxy access rights to serve special interests or that it will pose a distraction. In non-US markets, where shareholders have the right to propose alternative candidates in one form or the other, the right is rarely used. Instead, the existence of the right is an effective moderating tool on board actions.

Holding requirements are, in our opinion, effective safeguards to the misuse of proxy access rights. The additional limitation on the number of board seats that can be gained avoids that proxy access will be used for control purposes. Furthermore, any candidate that is proposed through proxy access must be approved by the general meeting. We have faith in the collective wisdom of shareholders to determine and elect the nominee best suited to serve their interests.

We are attracted to proxy access as the preferred route by which any shareholder, subject to a shareholding and tenure requirement, may propose board candidates for the next shareholder meeting. While we are supportive of closer involvement of shareholders in director nomination processes, we are not in favour of boards appointing new members mid-term. Specifically, a proxy access right may strengthen the case against boards yielding to shorter term pressures to appoint shareholder-affiliated board members during the term.

Over time we support a statutory basis for proxy access. In the absence of a universal rule, we will encourage boards of US companies to demonstrate leadership on this governance reform and to propose proxy access at appropriate terms. A confident, well-functioning board will not fear the right of proxy access. We will not be supportive of directors who seek to undermine shareholder efforts to introduce proxy access rights.

Finally, we acknowledge that our support for proxy access is shaped by our fund's long-term investment horizon and status as a minority investor.