



**REMARKS OF  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**BEFORE THE  
NATIONAL INVESTOR RELATIONS INSTITUTE'S  
FALL CONFERENCE**

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**\*The views expressed herein are those of Commissioner Schapiro and do not necessarily represent those of the Commission, other Commissioners or the staff.**

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**Good morning. I am very happy to be with you today to speak about one of my favorite topics, the changes to and improvements in the lines of communication among shareholders, directors, and the management of our nation's corporations.**

**As you are no doubt aware, the Commission last month adopted significant changes to the federal rules governing the solicitation of proxies and communications among shareholders. With the exception perhaps of rules adopted in 1990 to open up the foreign and domestic private placement markets through the enactment of Rule 144A, I believe that the proxy reform and executive compensation rules adopted last month are the most important in my tenure at the Commission.**

**I was truly pleased by the process as well as the results in our consideration of proxy reform, which unfortunately is not always the case. I think the process merits a few comments because in many ways it was extraordinary. As you may know, the SEC staff had been looking for some time at whether changes were needed in the proxy system, in part as a result of the interest and insistence of institutional shareholders who had submitted a variety of petitions for rulemaking covering many issues.**

There had also been, for some time, independent interest on the part of the staff and the Commission in looking at the proxy process. This was all ongoing when last year's proxy season brought us a record number of 14a-8 proposals on executive compensation - from individuals like Reverend Conti to large institutions. As a result, the Commissioners and the chairman became very involved in the resolution of those 14a-8 proposals and, as you know, we took the position that proposals concerning executive compensation no longer are to be considered "ordinary business." Because of our exposure through the 14a-8 process to the issues concerning not just levels of compensation, but more importantly the relationship between levels of pay and corporate performance, and the overall comprehensibility of pay disclosure, the Commission recognized that we needed to take a broader look at the issues. So we joined the topics of executive compensation and proxy reform into one major package. This was done not just for convenience, but because we thought the chance for real reform might only come once.

What was a little different in this rulemaking proceeding was the level of Commission involvement in the fundamental decisions as well as in the detail. Perhaps even more unusual than the collegiality was

the strength of the entire Commission's commitment to improving disclosure and facilitating shareholder communication. Throughout the course of the two year rulemaking the Commissioners stayed highly engaged in the process and surprisingly united in the face of intense and continuous lobbying from the business community ("if it ain't broke, don't fix it") to the large institutions and shareholder groups, which claimed we were not going nearly far enough or fast enough, to members of Congress, who pressured us to endorse a variety of legislative proposals to increase shareholder access to the proxy or to cap executive pay.

This is not to say that we did not have our differences within the agency, because we certainly did. For example, I did not agree with the announcement last February that we would examine, within 90 days, the issues of accounting for option based compensation and potential inclusion of that value as a corporate expense, despite the fact that FASB had been working on the issue for years and had been unable to agree upon a valuation method, and in light of the compelling arguments that had been made by the high-tech companies.

Ultimately, the combined efforts of the Commissioners, the staff, and hundreds of commenters from disparate market segments, played an important role in the enactment of meaningful, fundamental reforms to the Commission's proxy and executive compensation rules. Never have I seen the various sides to such a complex issue so ably represented in their comments as was the case in these proposals.

One final note about the commenting process. Although commenters were not always united in their opinions concerning what aspects of the proposals that they liked or did not like, they were unanimous in asking the Commission to clarify and simplify the regulatory environment in which they operate. I hope, and I think, that we were responsive to those comments.

The proxy rules will make it easier for shareholders to communicate with one another, to make their opinions known to managers and their Board, and to work for change in either corporate policy or management. Our markets and investors have changed dramatically since the Commission last revised the definition of the term "solicitation" in 1956. But what has not changed over that period is the fundamental notion that the owners of a company have

**the right to discuss, decide, and vote on substantive matters of importance to the corporation. The goals of the proxy amendments are to simplify regulatory requirements and remove regulatory impediments to the free exercise of those rights.**

**The amendments to compensation disclosure likewise will simplify shareholder assessments of executive pay, by moving away from pages and pages of dense, sometimes indecipherable narrative disclosure to more easily read and understood tables and graphs.**

**Let me take a few moments to describe some of the more significant elements of the new proxy rules. On a most basic level, the amendments provide an exemption from the proxy rules for communications by persons who are not seeking the solicitation of proxy authority and do not have a substantial interest in the matter. The changes are intended to eliminate provisions existing in the old rules that served to unnecessarily inhibit communications between shareholders. Because of the breadth of the definition of "solicitation," shareholders were often unsure about whether any comment or expression of views would in fact constitute a solicitation. This uncertainty obviously had a chilling effect on the exchange of views, to the detriment of the corporate franchise.**

**The new rules exempt a number of types of solicitations, thereby removing the question about coverage and the subsequent burdens and cost of federal regulation. Statements made pursuant to the newly created exemption are not subject to the filing and dissemination requirements, and to a large part are exempt from the new notice requirement as well. Oral communications made by eligible persons are completely exempt from the proxy rules, except of course the anti-fraud provisions of Rule 14a-9. Written statements carry a notice requirement, requiring the filing of the soliciting materials with the Commission and the exchanges within three days, but only when the soliciting person holds in excess of \$5 million of the issuer's securities.**

**Anyone outside nine identified categories is free to avail themselves of the exemption. In effect, the nine groups attempt to cover the concept of "interested person." Those categories include the registrant or its affiliate, officers and directors of the registrant acting on behalf of the registrant, officers and directors of another ineligible person, competing bidders or acquirors, Form 13D filers planning or reserving the right to seek control or elect directors, proxy solicitors hired by an ineligible person, interested persons of an**

investment company registrant, nominees, or any other person with a substantial interest other than as shareholder or employee. This categorization, along with the \$5 million notice threshold, should ensure that individual and institutional shareholders are free to communicate among themselves without the fear of unnecessary or excessive government intervention.

Other steps were taken intending to promote the free exchange of ideas among shareholders. For example, solicitations using the broadcast media or the press will no longer trigger an obligation to mail a proxy statement to all shareholders. Formerly, such use of a public forum was viewed as soliciting material furnished to all shareholders, thereby incurring the significant cost of mailing the materials to all shareholders. The amendment eliminates that cost, making such public communication possible where often it wasn't before. Likewise, announcements made by a shareholder as to how the shareholder intends to vote are not covered by the proxy rules. Further, solicitations may begin on the basis of preliminary proxy statements, allowing parties additional time to discuss proposals with shareholders prior to the dissemination of definitive materials and the proxy card.



**Despite the sense of satisfaction I feel about the Commission's efforts to free the flow of information among shareholders, I hesitate to refer to the amendments as a perfect package. The one area where I wish that we would have pushed a little farther was with shareholder lists.**

**The rule as it existed gave the registrant the option of either providing to a requesting shareholder a list of all shareholders or mailing the requesting shareholder's soliciting materials directly to the targeted group or subgroup of shareholders. As proposed, the amendments would have allowed shareholders in almost any context to have the option, instead of the registrant. As adopted, however, the mail or receive option remains with the registrant, except in the case of roll-ups and going-private transactions.**

**Although those two areas are a good place to start, I personally found merit in the comments by the academic and shareholder community supporting the provision as proposed. I worry about the costs that are controlled by registrants but passed on to requestors, and about the ability of registrants to resolicit, or follow the solicitor's mailings with materials of their own, while the shareholder lacks the ability to make continued responsive mailings. I intend to keep a**

watchful eye on this issue, to determine whether the positive but modest steps that we have taken in this area serve to satisfy shareholder participants.

I must confess, however, that my disappointment over the shareholder list issue is more than offset by the steps we took to correct a flaw in the bona fide nominee rule. As I have before, I must credit academics Ron Gilson, Lilli Gordon, and John Pound with getting me to focus clearly on this issue.

For everything that the proxy rule amendment package will do to improve the franchise by making the market for corporate information freer and more efficient, nothing makes the franchise more meaningful than the increased ability of shareholders to play a role in the nominating process. Facilitating the possibility of minority representation on the Board allows for constructive engagement, which is almost always preferable to a contest for control. The bona fide nominee rule changes will make it possible for dissident shareholders to nominate and elect a minority of directors to the Board.

The modifications to the bona fide nominee rule eliminated unintentional regulatory barriers to proposing or electing a minority of directors. As it stood, the rule prevented a dissident from including management's nominees on the same slate as his own nominees. The practical result was to either force the dissident to run a short slate, which partially disenfranchised those who voted for it, or to run a full slate of dissident nominees, hence commencing a contest for control.

The Commission chose a partial solution to the problem, opting not for the most simple approach that would permit the inclusion of some management nominees on the dissident's proxy. This simple fix approach was the target of a number of comments, mostly negative. Some corporate commentators argued that a change that facilitated minority representation was a bad idea, leading to a loss of collegiality and making the Board less effective. Of the hundreds of comments I read in connection with the proxy proposals, I found those to be the least compelling. Boards of directors are not supposed to act as fraternities or exclusive clubs, and a threatened loss of collegiality is far less important than the inability of dissatisfied investors to make their feelings known or the

commencement of a damaging and perhaps unnecessary fight for control.

As I said, the Commission did not opt for the simplest solution, but I believe the end result was a good one. As adopted, the bona fide nominee rule will no longer require a soliciting shareholder to ask other shareholders to forego voting for any management nominee. The soliciting shareholder will not, however, be allowed to use the names of company nominees to fill out the shareholder's slate without their consent. Instead, a soliciting shareholder can vote the proxy in favor of the company's nominees **other than those specifically excluded** by the soliciting shareholder. The soliciting shareholder must clearly disclose that the company's nominees have not agreed to serve if the dissident nominees are elected.

In the final analysis, the important question is: What will be the result of these initiatives? Well, hopefully, it will mean a more informed and enlightened shareholder community. We might then assume that a better informed shareholder base would lead to improved Board-shareholder communication, and more enlightened boards of directors - a goal that I believe is not merely laudable, but in fact is absolutely necessary.

I am also hopeful that strengthening the traditional lines of communication will result in a diminished need to explore new, and often imperfect, means of communication between shareholders and Boards of Directors. One such example is shareholder oversight committees. Last year, for example, Exxon Corp. received a shareholder proposal which would have required the creation of a committee of shareholder representatives. The proposal would have required the creation of a three person shareholder board with the responsibility for reviewing the efforts of the Board of Directors. Only sizeable, particularly institutional, shareholders would have been eligible, and the committee would have been permitted to include in the company's proxy statement a report evaluating the performance of the Board during the previous year.

To me this attempt to pave a new avenue for Board-shareholder communication was flawed. I was concerned about the institution of an oversight board without any clearly defined duties. I commented at the time that if a shareholder advisory committee truly were necessary, then the Board probably was not doing its job, and the idea of adding another layer of bureaucracy probably was not the best solution.

**I would like to believe that the steps we have taken to improve shareholders' communication with one another and with their Boards will result in the decline in the need or demand for such proposals, as shareholders begin to believe that they can make their views and preferences known to the Board and to management, and that they have legitimate options other than to vote with their feet.**

**I suspect, however, that we at the SEC cannot take the credit or responsibility for all developments in the realm of communication in the corporate community. There has been much discussion lately of "relationship investing," or the increase in interaction between corporations and their larger institutional investors. Terminology notwithstanding, the idea of institutional investors seeking influence in the boardroom certainly is not novel. CALPERS and other public pension funds have been on the cutting edge of shareholder activism, from crafting South Africa-less portfolios to immersing themselves in the one share, one vote debate of a few years ago. What has changed is the increased willingness of managements to listen, and the reduced ability of these massive pension funds to sell. As others have noted, when a fund's assets reach into the tens of billions of dollars, the ability to move in and out of stocks is hampered by the**

absence of other, similar investment choices, and the downward effect that large sales can have on the market. Corporate boards and managements have come to realize that they must listen, given the significant percentage of the market held in the hands of the large institutions. And more than listen, they must often negotiate with their largest shareholders.

Certainly any development that increases communication between owners and managers is a positive one. This movement in one way complements the Commission's proxy rules, but in another makes the rule changes even more important. My concern about the impact of large investors can only run so deep; financial reality will always go a long way toward protecting their franchise. I believe that the proxy rule amendments will permit, to an extent greater than ever before, small shareholders to interact to determine whether there is a mutuality of opinion or interest, regardless of whether or not it conforms with the interests of management and large shareholders.

I am proud of the steps the Commission has taken to protect and improve the corporate franchise for small and large investors alike. An informed electorate, in the corporate as in the political world, is essential to effective governance. I foresee the shareholder

**base of corporate America becoming increasingly more activist, making the boards likewise more activist, making their managers more responsive, and, finally, making their companies more competitive.**

**Thank you.**