Proxy Voting

SEC Rule May Stop New ESG Issues From Gaining Traction

By Rheaa Rao November 30, 2020

A new Securities and Exchange Commission rule could prevent companies from considering new types of environmental, social or governance issues that may affect their long-term value, analysts say.

In September, the SEC adopted amendments to a rule that impacts who can submit proposals to a shareholder vote, as well as which proposals can be resurfaced. The final rule increased the threshold for when shareholders can resubmit their proposals, as reported. It also increases the number of years a shareholder must be invested in a stock before submitting a proposal.

The rule will impact new issues that companies have not yet considered, says Michael Passoff, CEO at Proxy Insight, a firm that provides shareholder advocacy and proxy voting services to individuals, socially responsible investors and foundations. This includes issues underscored by the pandemic around worker safety, diversity, food safety and human rights, he says.

Under the SEC's new resubmission rule, proposals cannot be refiled for three years if they fail to gain traction and don't receive a certain threshold of support.

Often, shareholders engage with firms on topics for years before the public companies consider those issues to be legitimate concerns, Passoff says. For example, it took a long time for an issue like climate change to gain traction with companies.

Companies had to first be coaxed into revealing their greenhouse gas emissions output, says Cheryl Smith, portfolio manager and research analyst at Trillium Asset Management. Then, they were gradually pushed to create plans to reduce those emissions.

"[The resubmission rule] has a chilling effect on the ability to raise new issues and investor education on such issues," Smith says.

Trillium, for example, plans to develop more proposals regarding human rights, diversity and inclusion, Smith says. But the proposal's success will vary from company to company.

Depending on the firm, they may ask about internal diversity, hiring plans, pay equity or even to whom a firm markets its products, she explains. Such proposals could be impacted by the recent resubmission alterations.

The resubmission amendments would make 27% of social and environmental shareholder proposals voted on this year ineligible from consideration if the rule were applied to the 2020 proxy season, according to the **Sustainable Investment Institute**, a nonprofit research organization.

If the rule was already in effect, this would mean that proposals at several high-profile companies would be unable to resurface next year. This includes one at Facebook asking the board to nominate at least one candidate for the next board election with a high level of human or civil rights expertise. That issue received support from 3.6% of investors during the recent proxy reason. Under the new rule, a proposal can only be refiled if 5% of shareholders back it during the first year it's submitted.

Additionally, the SEC's new rule does not address the dual share class structure some companies have established, Passoff explains. Certain stocks at companies have higher voting power, enabling some shareholders to block proposals, he says.

"Refiling will become difficult at such companies if shareholders can't meet the new thresholds because of the way stock is held," Passoff says.

Companies may also invoke the new rule by arguing that proposals should be quashed because they're too similar to ones that didn't meet the resubmissions threshold, says Heidi Welsh, executive at Sustainable Investment Institute.

The new rule is set to kick in before the 2022 proxy season, notes Sanford Lewis, director of the **Shareholder Rights Group**, an advocacy organization that defends shareholders' rights to engage with public companies.

The number of ESG-related proxy filings will likely go up during the 2021 proxy season, as shareholders clamor for a "last opportunity" to squeeze in proposals they care about before the rule goes into effect, Lewis says.

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It’s also a possibility that the SEC, which is expected to gain a Democratic leader, could pursue new rulemaking to undo the recent proxy-related rules, he adds.

The SEC could extend the transition period if needed, to allow for more time to change the requirement, says Sara Crovitz, partner at Stradley Ronon.

The new rule also raises the bar for who can submit proposals. Investors with more than $2,000 invested in the company must hold those shares for three years before they can submit a proposal, the rule states. Those with $15,000 must wait two years, and investors with $25,000 or more must wait one.

However, the impact of the raised ownership threshold is not immediately discernible, analysts say. Public companies and investors don’t need to disclose exactly how much they own and since when, they say. And most filers, including religious groups that frequently submit proxy proposals, are either long-term investors or small institutions that have enough invested in a stock, Passoff says.

“The issue for smaller shareholders is liquidity, and to say that you have to hold shares for longer to file a proposal can impact their diversification,” Lewis says. “A substantial number of proposals are filed every year by shareholders who have held somewhere close to the $2,000 threshold, but not for long.”

Future proxy seasons will determine how many proposals were curbed because filers did not have enough invested in the company, Lewis says.

But proposals won’t just disappear if shareholder are ineligible to file, Proxy Insight’s Passoff says. Small institutions and individual shareholders often file proxy proposals when large investors are unable to discuss such issues directly with management, he adds.

“Instead, they’ll pressure larger shareholders, such as BlackRock or Vanguard, to take action at companies,” he says.

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