

TESTIMONY OF TIMOTHY SMITH  
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BEFORE THE COMMITTEE ON FINANCIAL SERVICES

U.S. House of Representatives

***SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS***

September 27, 2007

Mr. Chairman and Members of the Committee, it is an honor to provide testimony on the important issues contained in the Securities and Exchange Commission's (SEC) Releases No. 34-56160 and 34-56161 dealing with the questions of access and concepts related to Rule 14a-8, the sponsorship of shareholder resolutions.

I am Senior Vice President and Director of Socially Responsive Investing at Walden Asset Management<sup>1</sup>. I also serve as Chair of the Board of the Social Investment Forum<sup>2</sup>. In addition to these positions, my testimony today is informed by the nearly 30 years of experience gained serving as executive director of the Interfaith Center on Corporate Responsibility (ICCR).<sup>3</sup> And, of course, some of my remarks are personal views based on close to 40 years of experience working in this arena.

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<sup>1</sup> A division of Boston Trust & Investment Management Company, Walden is a Boston, MA-based firm that manages approximately \$1.7 billion for individual and institutional investors who are committed to integrating environmental, social and governance issues with their investment decisions.

<sup>2</sup> The Social Investment Forum (<http://www.socialinvest.org>) is the national membership association for the social investment industry. It is dedicated to the concept, practice and growth of socially responsible investing. The Forum's 500-plus membership include financial planners, banks, mutual fund companies, research companies, foundations and community investing institutions.

<sup>3</sup> ICCR is a coalition of approximately 300 religious and socially concerned investors. Their religious members, including Protestant, Jewish and Roman Catholic groups, have over \$110 billion in assets under management. With more than 35 years of experience, religious investors often are considered the pioneers of shareholder advocacy. ICCR and its religious members and social investment firm affiliates have addressed scores of issues over this 35 years, including apartheid in South Africa, diversity in employment, violence in video games, executive compensation, codes of conduct and vendor standards in the supply chain, drug pricing, climate change and the environment, among others.

At Walden Asset Management, we take our rights and responsibilities as shareowners seriously and actively engage companies on environmental, social and governance issues through proxy voting, letter writing, meetings with management and sponsorship of shareholder resolutions.

We have decades of experience in addressing companies on issues such as:

- Executive compensation
- Improved corporate governance
- Climate change
- Sensitivity to the environment and recycling
- Advocating for strong global supply chain policies and practices
- Encouraging expanded corporate transparency to investors

The ability to utilize shareholder proposals has been an essential tool in this process. For example, in 2007 Walden sponsored or co-sponsored more than 25 shareholder resolutions. Fortunately, we often come to agreements after submitting these resolutions and dialoguing with these companies, and more than 50 percent of the resolutions were withdrawn in light of these agreements.

We believe that companies with a strong governance record and leadership on environmental and social issues create long term shareholder value and thus protect investor interests.

Many investors, including representatives on this panel today, will testify to the importance of a reasonably crafted “access rule.” Walden Asset Management and the Social Investment Forum also support the right of access and oppose the SEC proposal prohibiting access to the proxy for the purpose of nominating Directors.

While other witnesses will explain in greater detail the problems with the SEC releases dealing with access to the proxy, my comments today will focus on the test questions raised by the Commission in Release No. 34-56160, File S7-16-07.

Simply put, if adopted, these concepts would either eliminate entirely or severely limit the ability of any investor to sponsor a shareholder proposal. The result would be both a curtailment of shareholder rights AND the elimination of meaningful investor input for corporate boards and management. These concerns are being reflected as well by the comments submitted to the SEC by thousands of individual and hundreds of institutional investors.

Our primary concerns are with three of the major concepts released for comment by the SEC, including:

1. Opt-Out Provision
2. Electronic Forum
3. Threshold for Resubmission of Non-binding Shareholder Resolutions

### The Opt-Out Approach

The SEC asks for comments on the right of a company to “opt-out” of the shareholder resolutions process, either by obtaining approval from shareholders through a proxy vote, or, if sanctioned under state law, by having a Board vote authorizing the company to opt-out.

An opt-out option would have significant negative consequences. The most unresponsive companies would be more likely to opt-out because resolutions are an important mechanism to strengthen corporate accountability. Companies with relatively poor investor communications would be empowered to isolate themselves further. Imagine a scenario where a Board criticized for poor governance and irresponsible behavior (e.g. backdating of options resulting in legal action against the company), simply decides it doesn't like the criticism and decides to opt-out. A company that had received a number of resolutions garnering strong shareholder votes – the company whose long-term value one

would think would best be served by Rule 14a-8 – would be the company most likely to accept the Commission’s invitation to opt-out of the process, and an important tool of accountability to investors evaporates overnight.

The lack of uniform rules that would result from an opt-out option also would be a complicating factor for both investors and companies.

We also cannot support an opt-out rule implemented through a shareholder vote. Far from an appropriate democratic process, this more accurately reflects the anti-democratic notion of *one share, one vote, one time*. Future shareholders will have no such voice.

This concept is particularly puzzling. The logic for allowing a company to withdraw from the resolution process is not explained and the motives of the Commission in presenting this option are unclear. The concept of allowing a board of directors or a company’s current shareholders to vote to disenfranchise future shareholders would seem to run contrary to the Commission’s commitment to universal shareholder suffrage.

We believe that the SEC should actively encourage companies to embrace checks and balances, and strong accountability mechanisms, rather than encourage them to take advantage of State laws that may enable them to disenfranchise and ignore their shareholders. We urge the SEC to drop the opt-out concept.

### The Electronic Petition Model or “Chat Room”

The release asks, “Should the Commission adopt a provision to enable companies to follow an electronic petition model for non-binding shareholder proposals in lieu of 14a-8?” This question builds on the SEC Roundtable discussion of “electronic chat rooms” and suggests that such a forum could substitute for the right to file shareholder resolutions.

While we support new forms of electronic communication between investors and the Board and management, we view it as a supplement to, not a substitute for, the existing shareholder resolution process.

For example, a number of companies have set up e-mail boxes for Directors in their capacity as Chair of the Governance Committee or Compensation Committee and correspondence is encouraged. We are pleased the SEC is open to examining such new electronic communication approaches. We also support creative new concepts of future forums for exchange of views or even informal polls of those investors who are signed into the forum.

Regrettably, it is not at all clear in the Release what the Commission intends with respect to electronic “chat rooms.” Certainly, the Commission has not articulated any clear rationale for replacing the current orderly and successful accountability mechanism of the shareholder process with an untested forum that is likely to be

ignored by serious investors at best, and open to a wide range of fraudulent activity at worst. A wide range of credible concerns were raised during the Commission's public roundtable discussions on the proxy process in May. The concept is fraught with logistical difficulties and unanswered questions.

Presently, shareholder resolutions assure that management and the Board focus on the issue at hand since it is included in the proxy and debated at the annual stockholder meeting. Additionally, each and every investor receiving a proxy has the opportunity to consider the proxy item and cast a vote. Substituting a chat room or other form of electronic petition for the current proxy process would eliminate a valuable fiduciary tool.

The process today guarantees that all shareholders have equal access to the same information. A chat room or electronic forum with a daily (if not more frequently) exchange of information would create an information environment that no single shareholder could adequately monitor. Assuming this forum hosts valuable discussions – a debatable assumption considering the current electronic forums that exist today – technologically savvy investors, or those with a large staff to monitor these exchanges, would be placed at an advantage over other shareholders.

We believe that responsible fiduciaries would be unable or unlikely to monitor a “chat room” on a daily basis in order to weed through the variety of random



shareholder concerns raised to find the information that is material to their decisions. The rise in shareholder votes on advisory shareholder resolutions over the past few years attests to the fact that these fiduciaries are taking these issues seriously, and are finding value in the proxy statement as currently utilized and regulated.

In addition, there is no assurance that a significant percentage of investors will utilize the Forum, thus any “poll” would be only of those investors who signed up, providing no reasonable assessment of the range of investor views on a topic, and no clearly established universal method for counting the votes. In fact, it is unclear whether companies would even be required to disclose the results of these periodic ‘straw polls.’

It also is unclear how investors who recently sold their shares or added to their holdings would be treated. In the proxy process there is a date of record when the clock stops and investor shares are counted. Will there need to be a series of “dates of record” with proof of ownership provided for each poll that is taken on the Forum? Will an unregulated forum simply exacerbate the influence of short-term investors?

Finally, as noted above, there are many investors who may be unable to join the Forum, thus creating two classes of investors, some disenfranchised.

Chat rooms and electronic forums are welcome approaches for enhancing communication with investors. They are not a substitute for a shareholder's right to file resolutions.

### Resubmission Thresholds

The Commission asks whether the voting thresholds for resubmitting resolutions should be increased. Presently, the resubmission thresholds stand at 3% to re-file resolutions after the first year, 6% after the second year and 10% thereafter. The SEC is testing the concept of increasing the thresholds to 10%, 15% and 20%, respectively.

In responding to this question, it is important to assess the business community's and SEC's need for "relief" from the resolution process, and to evaluate the impact of the suggested change on shareholder proponents.

### ***Impact on Companies***

Recent experience shows that a small minority of publicly traded companies receive shareholder resolutions. In 2006 and 2007, there were fewer than 1,200 resolutions filed at less than 1,000 companies. This represents fewer than 20% of companies. Clearly, the business community is not burdened significantly by the resolution process. Resolutions overwhelmingly are filed with large cap

companies with the greatest resources. Mid cap and small cap companies rarely, if ever, receive resolutions. We have seen no data that supports the argument that corporations are overwhelmed by this process, and we can very clearly document the numerous and substantial long-term benefits to shareholder value that has been created through the non-binding resolution process.

Companies with a number of resolutions, such as Exxon Mobil or Home Depot, seem to have developed an orderly process for addressing them. Moreover, companies with multiple resolutions are frequently embroiled in significant public controversies, thereby reinforcing the resolution process as an important vehicle for shareholders to address their concerns.

In fact, according to publications issued by Institutional Shareholder Services (ISS) and the Interfaith Center on Corporate Responsibility (ICCR), about one-quarter to one-third of resolutions are withdrawn each year. These never appear on proxy statements because mutually acceptable agreements are struck between investor proponents and companies. Hence, by being responsive to investor concerns, companies usually have opportunities to avoid proxy resolutions.

### ***Impact on the SEC***

We understand the significance of the SEC's role as arbiter when companies petition for *No Action* letters to omit resolutions from their proxy statements.

Fortunately, the number of such requests decreased to 237 in 2007 from 259 in 2006. Also, we believe the SEC workload is mitigated to the extent that many *No Action* requests address pro forma decisions (e.g. late submissions or challenges with respect to proof of ownership), or issues previously raised at other companies.

Nonetheless, we know that *No Action* letters are a seasonal pressure for the SEC. But as investor proponents and companies indicated 10 years ago when this question was last debated and comments submitted to the SEC, there is a strong desire and mutual need to have the SEC act as an arbiter of the *No Action* process. It has been the experience of our members that SEC staff has been able to effectively handle numerous no-action requests over the years.

There is no other means to ensure that both proponents and issuers are treated fairly and consistently. We conclude that Rule 14a-8 has evolved into a critically important check on corporate behavior and there may be no practical substitute for a lengthy and somewhat burdensome no-action process.

### ***Impact on Shareholder Proponents***

From the viewpoint of proponents, it is clear that a major increase in resubmission thresholds would have a significant chilling effect on a range of resolutions on important topics. Looking back to the 1970s and 1980s, the early

days of shareholder advocacy, we saw that new proxy issues often took time to develop traction among large groups of investors. On topics as diverse as apartheid in South Africa, corporate governance reform or climate change, investors needed time to gain knowledge and evaluate a corporation's response in fulfilling their fiduciary duty to vote proxies conscientiously. Raising resubmission thresholds as suggested would stifle this engagement that we believe is in the long term interests of companies and their shareholders.

It would further enhance the current short-term perspective of our capital markets to exclude those issues that have not yet become "material" to a majority of institutional investors. Unfortunately, by the time many of these risks, such as climate change, do garner widespread support; it may be too late to address them. The current vote thresholds are sufficiently low to permit these issues to return year after to year and gradually build support. The current thresholds serve those fiduciaries who wish to take a more prudent approach to risk, preferring to encourage boards to begin to address risks now that are not yet recognized by less forward-looking investors. The SEC should be seeking to enhance these fiduciaries' abilities to fulfill their duties.

If we focus on the 2006 resolutions addressing environmental and social issues, about 14% of the total number of resolutions filed, it seems clear that the suggested new thresholds would negatively impact emerging shareholder concerns. According to the ISS Social Issues Service in its final report on the

2006 season (*Social Policy Shareholders Resolutions in 2006: Issues, Votes and Views of Institutional Investors*), 198 shareholder proposals came to votes on social and environmental topics at U.S. companies, of which 160 (81%) earned enough support (under the 3-6-10 percent rule) for resubmission. Had the resubmission thresholds been 10-15-20 percent in 2006, only 71 of resolutions (36%) would have earned enough support for resubmission – a dramatically negative change for shareholder proponents (see table below).

### **Effect of Resubmission Thresholds on 2006 Resolutions**

<b>Effect of Resubmission Thresholds on 2006 Social/Environmental Proposals</b>		
<b>Resubmission Threshold</b>	<b>Proposed: 10-15-20%</b>	<b>Curent: 3-6-10%</b>
• First Year	53	119
• Second Year	13	29
• Third Year	5	12
<b>Total (as percent of 198 resolutions)</b>	<b>71 (36%)</b>	<b>160 (81%)</b>
Source: Institutional Shareholder Services		

Consolidated data on all shareholder proposals from 2000-2006 in the next table confirms the substantial impact on investor proponents, albeit less dramatic for resolutions addressing corporate governance topics.

<b>Support for Shareholder Proposals 2000-2006</b>		
<b>Shareholder Proposals</b>	<b>Social Issues</b>	<b>Governance Issues</b>
• Total Voted on	1168	2551
• With support of at least 10%	350	2041
• With support of at least 15%	180	1797
• With support of at least 20%	138	1655
Note: Support percentage is calculated as percent of shares cast “for” out of shares cast “for” and “against.”		
Source: Institutional Shareholder Services		

Clearly, management of some companies may want to limit or eliminate social and environmental resolutions because they are viewed as frivolous or not significant business matters. Yet, increasingly the evidence suggests, and major institutional investors believe, that strong performance on environmental and social concerns such as climate change, water scarcity or global supply chain management, among others, has an impact on with long term business success. Given their importance, we believe that the relatively small number of shareholder resolutions on environmental and social issues does not present a significant burden to companies or the SEC.

In considering the impact on investors it is important to understand that many proponents view the proxy resolution as a “last resort” attempt at engagement, an avenue that helps ensure concerns are heard by top management and board members. TIAA-CREF, for example, describes this philosophy in its recently updated Governance Policy. If a company repeatedly refuses to respond to correspondence or requests for meetings with its investors, the shareholder resolution often acts as impetus for improved communications. Adding more restrictive thresholds on resubmitting resolutions simply makes it more difficult for investors who seek constructive engagement with companies.

In positing this question, it should be noted that the SEC has not made a case for why this change is warranted, what the impact on shareholder proposals would

be and how such a change would advance the public interest. The new threshold numbers are presented without any discussion of the criteria used to select them.

## **THE IMPACT OF RESOLUTIONS**

Volumes of evidence demonstrate the clear, effective and positive impact of shareholder engagement and resolutions on company policies and behavior. While the shareholder resolutions process may result in a handful of frivolous resolutions in proxies, the vast majority raise issues that are important for shareowners and provide constructive input to the corporate decision making process.

In fact, some resolutions actually stimulate a market wide trend. For example, the resolutions requesting that Directors be elected with a majority vote or that stock options be expensed (before it was required), have prompted changes in company policies. Resolutions alerting companies to the financial and environmental dangers of climate change also served as an important early warning system with companies by the hundreds moving forward on these issues.

The recent headlines on the problems with toy manufacturers in China with lead paint are a powerful reminder of the fact that supply chain issues can and do affect brand reputation and stock price, highlighting the crucial role investors



have played in encouraging companies to have strong codes and comprehensive auditing and disclosure.

The positive effect of shareholder resolutions is evident today in the thousands of companies that have spoken out embracing good governance as essential for long-term value. It is found in the statements of the hundreds of CEO's who have stated that leadership in social and environmental issues is important for the long term success and value of the company.

From Colgate Palmolive to Coca-Cola, from Intel to Ford and General Motors, from Pfizer to IBM, from BP to Hershey, companies are embracing many of the changes presented by shareholder proponents and see these reforms as "good for business."

The state and city pension funds, the mutual funds and investment firms, the foundations and labor union pension funds, and the religious investors who are resolution sponsors, all share a profound and deep concern for protecting and creating shareholder value. For many, it is a legal and fiduciary duty.

The importance of integrating environmental, social and governance factors into the investment process to long term protect shareholder value is articulated clearly and succinctly in the recently adopted Policy Statement on Corporate Governance of TIAA-CREF . TIAA-CREF's policy also reminds investors that it is

impossible to separate governance, social and environmental issues from their fiduciary responsibility.

Far from representing a “special interest,” shareholder proponents seek to advance broad investor interests AND the long-term interests of the corporation.

These proponents include substantial investors with literally trillions of dollars of invested assets. They include TIAA-CREF, state and city pension funds in California, Connecticut, New York State and City, Maine, Wisconsin and Minnesota. They include the Sisters of Charity, the Sisters of Mercy, Catholic Healthcare West, the Presbyterian, American Baptist and United Methodist Churches.

They include mutual funds and investment managers such as Walden Asset Management, Domini Social Investments, the Calvert Group, Trillium Asset Management, F & C Asset Management. And of course, small individual investors.

Far from advancing a narrow special interest these investors have a broad long-term interest in mind.

## **CONCLUSION**

Hundreds of organizations and thousands of investors have urged the SEC to reject these attempts to eliminate or curtail shareholder rights under existing Rule 14a-8. We encourage this Committee and Congress to voice its opposition as well and to remind the SEC of its mandate to protect the rights and interests of investors.