

CORPORATE GOVERNANCE

Position

RILA supports balanced measures to strengthen corporate governance, including reasonable reforms to executive compensation practices, that would strengthen shareholder communications and information without impeding the innovation, responsible risk taking, and strategic decision making of the nation's retailers. RILA is opposed, however, to one-size-fits-all proposals that would impose unnecessary, costly, and overly restrictive corporate governance requirements on publicly traded corporations, which include the vast majority of retail leaders.

Recent Activity

In the wake of the crises in the financial and mortgage sectors, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹ The bill includes a number of corporate governance provisions – namely requirements that the Securities and Exchange Commission (SEC) issue rules that:

- expand shareholder nomination of directors (the so-called “proxy access” rules) (Section 971);
- require companies to hold a non-binding shareholder vote on executive compensation (the so-called “say-on-pay” vote), which must occur annually, biennially, or triennially as determined by the shareholders (Section 951);
- require companies to disclose the ratio of CEO compensation to median employee salary as well as the relationship between executive compensation and the financial performance of the company (Section 953);
- require companies to develop and implement policies to recover compensation in the case of certain accounting restatements (so-called “compensation claw-back” policies) (Section 954), and
- establish a whistleblower program under which the SEC will pay an award to whistleblowers who voluntarily provide original information about a violation of the federal securities laws that leads to the successful enforcement action a company (Section 922).

Prior to the Dodd-Frank legislation, the SEC issued several proposals concerning corporate governance. On July 1, 2009, the SEC issued a proposed rule titled, “Proxy Disclosure and Solicitation Enhancements,” which would, among other things, expand existing compensation disclosure requirements to include the relationship of the company's compensation policies to risk, and impose new disclosure requirements concerning the qualifications of directors, executive officers and nominees and the company's leadership structure.² RILA submitted comments on the proposed rule, urging the SEC to avoid a one-size-fits-all rule and recommending substantial revisions to prevent unnecessary burdens and potential competitive harm to retailers.³ A final rule on proxy disclosure was approved by the SEC on December 16, 2009.⁴

On August 25, 2010, the SEC finalized its rule titled “Facilitating Shareholder Director Nominations,” commonly referred to as the proxy-access rule.⁵ This proposed rule would allow certain large shareholders and shareholder groups (i.e., those owning at least 3 percent of the voting shares for at least 3 years) to include in the company's proxy materials (at the company's expense) nominations for up to 25 percent of the company's directors. On July 22, 2011, the District of Columbia Circuit Court of Appeals vacated the SEC's proxy-access regulations, finding that the regulations were arbitrary and capricious under the Administrative Procedure Act and that the SEC failed to assess properly the rules' effects on “efficiency, competition and capital formation” as required by law.⁶

The SEC also released proposed rules regarding the say-on-pay vote on October 18, 2010,⁷ and final rules concerning the whistleblower program on May 25, 2011.⁸

While the SEC is not expected to take up the CEO-median employee compensation disclosure requirements under the Dodd-Frank bill until the next year, RILA submitted a pre-comment letter outlining the significant costs and burdens that the disclosure requirement poses for the retail industry.⁹ In addition, on June 22,

2011, the House Financial Services Committee reported favorably the Burdensome Data Collection Relief Act,¹⁰ which would repeal the compensation-ratio disclosure requirement, and action in the full House is expected.

Action Needed

RILA urges the SEC to recognize the inherent administrative complexities and burdens of the new executive compensation disclosure requirements and issue rules that implement them in the least burdensome manner possible. RILA also urges Congress to address the serious administrative obstacles that exist in the compensation disclosure requirement that will significantly impede compliance.

Background

Corporate governance has generally been within the purview of the states and prescribed by the state laws in which a business is incorporated. A fundamental tenet of state corporate law is that shareholders, as investors in the company, have the right to elect directors who represent them on the corporation's board of directors, which in turn hires executives to manage the day-to-day operations of the company. The responsibility of the board and management is to pursue policies that will achieve successful outcomes for the corporation and enhance the value of the shareholders' investments in the company. Shareholders do not have direct management control of the company, although they are generally accorded a say on certain major events affecting a corporation, such as merger and acquisition transactions and equity-compensation plans.

While the federal securities laws were never intended to regulate the internal affairs and management of corporations, they do play a significant role in ensuring that shareholders have sufficient information to exercise their voting rights. SEC rules require companies to disclose extensive information about the operating and financial results of publicly traded corporations as well as a wide array of information, including corporate management, executive compensation, internal controls, risk management, litigation, and contingencies.

Recent legislation and proposals by the SEC are intended to give shareholders more detailed information and more direct access to the management of the corporations in which they invest. However, due to the size of publicly trade corporations and the constant turnover in their shareholders, it is not feasible to operate such a business as a pure shareholder democracy. Such a fundamental shift in corporate control would create a host of unintended consequences, such as:

- Large institutional shareholders nominating and electing directors to advance particular political or social policies, or simply the minority shareholder's own immediate financial interests, which would focus the board of directors on achieving short-term returns rather than pursuing long-term strategic initiatives for the betterment of the company.
- Persistent threats of director-election contests that would result in an adversarial relationship between shareholders and the company rather than one premised on common goals and the successful operation of the company.
- Companies having to disclose information on certain risk, leadership structures, performance targets and incentives as well as director qualifications, which may reveal business strategies and other proprietary information that would compromise the company.
- Replicate the existing explanation, contained in the Compensation Discussion and Analysis, of how the compensation committees structured executive compensation to motivate performance or alternatively, lead to boilerplate disclosure that adds little, if any, insight for investors and unnecessarily adding to already lengthy pay disclosures.
- Required disclosure of more detailed information on executive compensation, and with respect to more than just senior executives, which would permit competitors to hire away senior personnel from the company.
- Encourage the use of formulaic approaches to executive compensation that limit board judgment and the use of metrics that drive long-term performance.
- Create confusion and erroneous comparisons between companies based on compensation ratio due to inherent differences in business models, staffing, and compensation practices as well as meaningless comparison between companies in different industries that could be used unfairly to cause reputational harm.

- Proxy materials that are so replete with unfiltered information that they are not useful to the shareholders they are intended to inform, thereby further disenfranchising retail shareholders and placing even more reliance on third-party advisory services to interpret these documents and present voting recommendations without having any vested interest in the companies.

RILA member companies have built strong relationships with their shareholders, and through strong, positive dialogues between shareholders and company directors and management, RILA members have listened and responded to many shareholders concerns and proposals to improve corporate governance in recent years. RILA members' boards and management work hard to make sure that strategic and operating plans are in place to control risk-taking appropriately and to ensure the long-term success of the corporation and long-term enhancement of shareholder value. Legislative and regulatory proposals that threaten that balance undermine well-performing boards and, thus, are not in the best interest of, and could ultimately be detrimental to, the corporations and their shareholders.

Contact

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¹ Public Law 111-203 (Jul. 21, 2010) – available at: <http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf>.

² 74 Fed. Reg. 35076 (2009) (to be codified at 17 CFR PARTS 229, 239, 240, 249, 270 and 274) (proposed Jul. 10, 2009) – <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>.

³ Letter from Mark E. Warren, Vice President, Tax and Finance, Retail Industry Leaders Association, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Sep. 15, 2009) – available at: <http://www.rila.org/news/pblcomments/Testimony%20Documents/RILA%20Comments%20re%20SEC%20File%20S7-13-09.pdf>.

⁴ 74 Fed. Reg. 68334 (2009) (to be codified at 17 CFR Parts 229, 239, 240, 249 and 274) (adopted Dec. 16, 2009) – available at: <http://www.sec.gov/rules/final/2009/33-9089.pdf>.

⁵ 74 Fed. Reg. 56668 (2010) (to be codified at 17 CFR Parts 200, 232, 240 and 249) (adopted Aug. 25, 2010) – available at: <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

⁶ Business Roundtable & Chamber of Commerce v. U.S. Securities and Exchange Commission, Case No. 10-1305 (Sept. 29, 2010) – available at:

[http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/\\$file/10-1305-1320103.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf).

⁷ 74 Fed. Reg. 66590 (2010) (to be codified at 17 CFR Parts 229, 240, and 249) (adopted Oct. 18, 2010) – available at: <http://www.sec.gov/rules/proposed/2010/33-9153fr.pdf>.

⁸ 75 Fed. Reg. 34300 (2011) (to be codified at 17 CFR Parts 240 and 249) (adopted May 25, 2011) – available at: <http://sec.gov/rules/final/2011/34-64545.pdf>.

⁹ Letter from Mark E. Warren, Vice President, Tax and Finance, Retail Industry Leaders Association, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Oct. 27, 2010) – available at: <http://www.rila.org/email/RILACommentsDodd-FrankSec953.pdf>.

¹⁰ H.R. 1062, 112th Cong., 1st Sess. (May 25, 2011) – available at: http://financialservices.house.gov/UploadedFiles/HR1062_REPSUBCOM_xml.pdf. See also, Letter from Bill Hughes, Senior Vice President, Government Affairs, Retail Industry Leaders Association, to the Hon. Spencer Bachus, Chairman, Committee on Financial Services, U.S. House of Representatives (Jun. 20, 2011) – available at: <http://www.rila.org/email/HR1062supportletterHFChairman.pdf>.