

**Testimony Concerning
“Protecting Shareholders and Enhancing Public Confidence by Improving
Corporate Governance”**

by Meredith B. Cross
Director, Division of Corporation Finance
United States Securities and Exchange Commission

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Introduction

Good afternoon Chairman Reed, Ranking Member Bunning, and Members of the Subcommittee. My name is Meredith Cross, and I am the Director of the Division of Corporation Finance at the U.S. Securities and Exchange Commission. I just re-joined the SEC staff in June of this year after more than 10 years in private practice here in Washington. I worked at the SEC for most of the 1990’s, and I am delighted to be back at the agency at this critical time in the regulation of our financial markets. I am pleased to testify on behalf of the Commission today on the topics of corporate governance and the agency’s ongoing efforts to assure that investors have the information they need to make educated investment and voting decisions.

Investor confidence is critical to our securities markets. In the context of the issues that the Subcommittee is discussing today, investors need to feel confident that they have the information they need to make educated decisions about their investments, including whether to re-elect or replace members of the board of directors. Good corporate governance is essential to investor confidence in the markets, and it cannot exist without transparency – that is, timely and complete disclosure of material

information. In responding to the market crisis and erosion of investor confidence, the Commission has identified and taken steps over the past months in a number of significant areas where the Commission believes enhanced disclosure standards and other rule changes may further address the concerns of the investing public.

Shareholder Director Nominations

A fundamental concept underlying corporate law is that a company's board of directors, while charged with managerial oversight of the company, is accountable to its shareholders who have the power to elect the board. Thus, boards are accountable to shareholders for their decisions concerning, among other things, executive pay, and for their oversight of the companies' management and operations, including the risks that companies undertake. While shareholders have a right under state corporate law to nominate candidates for a company's board of directors, it can be costly to conduct a proxy contest, so this right is only rarely exercised.

The Commission's proxy rules seek to enable the corporate proxy process to function, as nearly as possible, as a replacement for in-person participation at a meeting of shareholders. With the wide dispersion of stock prevalent in today's markets, requiring actual in-person participation at a shareholders' meeting is not a feasible way for most shareholders to exercise their rights – including their rights to nominate and elect directors. Two months ago, the Commission voted to approve for notice and comment proposals that are designed to help shareholders to more effectively exercise

their state law right to nominate directors.¹

Under the proposals, shareholders who otherwise have the right to nominate directors at a shareholder meeting would, subject to certain conditions, be able to have a limited number of nominees included in the company proxy materials that are sent to all shareholders whose votes are being solicited. To be eligible to have a nominee or nominees included in a company's proxy materials, a shareholder would have to meet certain security ownership requirements and other specified criteria, provide certifications about the shareholder's intent, and file a notice with the Commission of its intent to nominate a candidate. The notice would include specified disclosure about the nominating shareholder and the nominee for inclusion in the company's proxy materials. This aspect of the proposals is designed to provide important information to all shareholders about qualifying shareholder board nominees so that shareholders can make a more informed voting decision.

To further facilitate shareholder involvement in the director nomination process, the proposals also include amendments to Rule 14a-8 under the Exchange Act, which currently allows a company to exclude from its proxy materials a shareholder proposal that relates to a nomination or an election for membership on the company's board of directors or a procedure for such nomination or election. This so-called "election exclusion" can prevent a shareholder from including in a company's proxy materials a shareholder proposal that would amend, or that requests an amendment to, a company's

¹ "Facilitating Shareholder Director Nominations," Securities Exchange Act Release No. 34-60089 (June 10, 2009). The Commission's vote was 3-2 in favor of the proposal, with Chairman Schapiro and Commissioners Walter and Aguilar voting to approve the staff's recommendation to propose rules, and Commissioners Casey and Paredes voting not to approve the staff's recommendation. For the Commissioners' statements regarding the proposal at the Commission meeting at which the proposal was considered, see <http://www.sec.gov/news/speech.shtml#chair>.

governing documents regarding nomination procedures or disclosures related to shareholder nominations. Under the proposed amendment to the shareholder proposal rule, companies would be required to include such proposals in their proxy materials, provided the other requirements of the rule are met.

The proposing release seeks comments from the public on the rule proposals generally and also includes numerous specific questions. The comment process is a critical component of every rulemaking, and one that the Commission takes very seriously. We sincerely want to hear from all interested parties and truly believe that the rulemaking process is better informed as a result of the comments that we receive.

Proxy Disclosure Enhancements

One of the key disclosure documents for shareholders in deciding how to vote in the election of directors is the proxy statement. This document, which includes information about the directors, certain board practices, executive compensation, related party transactions, and other matters, is a critical component of the U.S. corporate governance landscape. The Commission, on July 1, voted to propose a series of rule amendments that are designed to significantly improve proxy disclosures, thereby enabling shareholders to make more informed voting decisions.²

One area that has garnered significant public attention and can drive investors' investment and voting decisions is executive compensation. The Commission's existing disclosure rules are designed to elicit comprehensive and detailed information about all elements of a company's compensation practices and procedures with respect to its most

² "Proxy Disclosure and Solicitation Enhancements," Securities Exchange Act Release No. 34-60280 (July 10, 2009).

senior executives. This information includes a “Compensation, Discussion and Analysis”; detailed tables followed by related narrative disclosure; and a report from the Compensation Committee. Based on this information, investors can form opinions about a company’s executive compensation policies, including whether the board of directors has acted appropriately in setting incentives and rewards for management.

Today, if material, a company must discuss the risk considerations of its compensation policies and decisions with respect to its “named executive officers.” (“Named executive officers” generally include the chief executive officer, chief financial officer, and next three highest paid officers.) Some have argued, however, that the recent financial crisis has demonstrated that a company’s compensation practices beyond these five named executive officers can have a dramatic impact on its risk profile; the manner in which some trading arms of financial institutions have been compensated would be an example. Therefore, the Commission has proposed requiring disclosure about how the company incentivizes its employees – beyond the named executive officers – if its compensation policies may result in material risks to the company. This disclosure is intended to enable investors to gauge whether the company’s compensation policies create appropriate incentives for its employees, as opposed to creating incentives for employees to act in a way that creates risks not aligned with the risk objectives of the company.

The Commission’s recent proxy enhancement proposals also would require expanded information about the qualifications of directors and director candidates, about the board’s leadership structure and role in risk management, and about potential conflicts of interests of compensation consultants. The proposals also would improve the

reporting of annual stock and option awards to company executives and directors, and would require quicker reporting of shareholder vote results. The Commission believes that all of this information would enable shareholders to more intelligently exercise their proxy vote, thereby further enhancing corporate accountability.

Broker Discretionary Voting

Also on July 1, the Commission approved changes to New York Stock Exchange Rule 452, which governs broker discretionary voting, to prohibit brokers from voting shares held in street name in director elections unless they have received specific voting instructions from their customers.³ NYSE Rule 452 generally allows brokers to vote such shares on behalf of their customers in uncontested director elections, as such elections are currently deemed to be “routine;” under the revised rule, such elections will no longer be deemed to be routine. This amendment, which the NYSE approved at least in part based on recommendations from the NYSE’s Proxy Working Group, will become effective on January 1, 2010.

The Commission also has asked that the staff undertake – this year – a comprehensive review of other potential improvements to the proxy voting system and rules governing shareholder communications, including exploring whether issuers should

³ “Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company,” Securities Exchange Act Release No. 34-60215 (July 1, 2009). The Commission’s vote was 3-2 in favor of the proposal, with Chairman Schapiro and Commissioners Walter and Aguilar voting to approve the rule change, and Commissioners Casey and Paredes voting not to approve the rule change. For the Commissioners’ statements regarding the proposal at the Commission meeting at which the rule change was approved, *see* <http://www.sec.gov/news/speech.shtml#chair>.

have better means to communicate with street name holders. With over 800 billion shares being voted annually at over 7,000 company meetings, it is imperative that our proxy voting process work well, beginning with the quality of disclosure and continuing through to the integrity of the vote results.

Say-on-Pay for TARP Companies

Also on July 1, the Commission proposed amendments to the proxy rules to set out the requirements for a say-on-pay vote at public companies that that have received (and not repaid) financial assistance under the Troubled Asset Relief Program.⁴ Under the Emergency Economic Stabilization Act of 2009, these companies are required to permit an annual advisory shareholder vote on executive compensation. Consistent with the EESA, the Commission's proposals would require public companies that are TARP recipients to provide a separate shareholder vote on executive compensation in proxy solicitations during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding. These proposals are intended to clarify what is necessary under the Commission's proxy rules to comply with the EESA vote requirement and help to assure that TARP recipients provide useful information to shareholders about the nature of the required advisory vote on executive compensation.

Conclusion

As governance and compensation practices continue to evolve, the Commission will remain vigilant in seeking to assure that our disclosure rules provide investors with

⁴ "Shareholder Approval of Executive Compensation of TARP Recipients," Securities Exchange Act Release No. 34-60218 (July 1, 2009).

the information they need to make informed investment and voting decisions. We know that there also is a great deal of thought and work outside the agency regarding corporate governance and executive compensation best practices, and we stand ready to lend whatever assistance we can in those efforts.

Thank you again for inviting me to appear before you today and for the Subcommittee's support of the agency in its efforts at this critical time for the nation's investors. I would be happy to answer any questions you may have.