CORPORATE GOVERNANCE

AND FINANCIAL REPORTING

The U.S. Chamber of Commerce is passionately committed to promoting the hopeful vision of economic freedom. Companies and entrepreneurs will survive only if they are able to understand, respond to, and serve the needs of customers. And companies will succeed only if they are able to attract, motivate, and reward people to work passionately and productively to serve those customers.

The fundamental challenge we face today is to preserve the ability of our nation's companies to grow, innovate, and drive prosperity under a system of free and fair capitalism, while also acknowledging and addressing the shortcomings in the system. The Chamber—through its Project Growth and Opportunity or "Project GO"—is committed to identifying practical, sustainable ways to address socio-economic challenges.

Reporting of environmental, social, and governance (ESG) activity has been at the forefront of conversations with the investment community and politicians. Investment professionals are in search of useful information, that may not be conspicuously available in financial statements, to inform if a company is positioning itself to create long-term value for its shareholders. On the flip side, some special interest activists have attempted to use ESG to force companies to take certain environmental or social stances that are not necessarily aligned with creating shareholder value.

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The number of companies that have chosen to voluntarily publish annual ESG reports has grown significantly in recent years, with 86% of companies in the S&P 500 voluntarily publishing such reports. ESG disclosures measure a company's non-financial performance indicators, which include sustainability practices, social criteria, and corporate governance issues. Examples can include quantifying the company's greenhouse gas emissions or sharing details about the board's diversity and structure.

ESG reporting is developing organically—it does not require rigid regulations. In fact, these may do more harm than good if they require disclosure of nonmaterial information that is not useful to investors, also imposing unnecessary costs on firms filing securities disclosures.

CCMC released principles for ESG reporting in 2019 to inform filers, and the public, about best practices. The report notes ESG reporting should do the following:

- Be tied to long-term value creation.
- Consider the audience.
- Be written in plain English and clearly describe the metrics used.
- Be overseen by someone who owns sustainability reporting at the company.
- Fit the needs of that particular company and industry.

SEC: IMPLEMENT NEW PROXY ADVISORY FIRM RULES

Despite being plagued by conflicts of interest, a lack of transparency, and significant errors in voting recommendations, proxy advisory firms continue to carry a significant amount of influence over corporate governance at America's public companies. The two dominant proxy firms—Institutional Shareholder Services (ISS) and Glass Lewis—control roughly 97% of the proxy advisory industry, constituting a duopoly that has become the de facto standard setter for corporate governance in the U.S. without any meaningful input from shareholders or issuers. The status quo has created distortions in the capital markets and has made it more difficult for companies to go and stay public.

The House of Representatives was so concerned over the lack of oversight in this area that it sought to regulate these firms by passing the bipartisan Corporate Governance Reform and Transparency Act of 2017 (H.R. 3015—115th). Similar bipartisan legislation was also introduced in the Senate as the Corporate Governance Fairness Act (S. 3614–115th).

In July 2020, the SEC adopted a rule that provides investors using proxy voting advice more transparent, accurate, and complete information, and provided supplemental guidance regarding proxy voting responsibilities of investment advisers. The rule codifies the SEC's longstanding position that proxy advice is generally a "solicitation" under SEC rules and reaffirms that the anti-fraud provisions under Exchange Act Rule 14a-9 apply to proxy advisory firms.

Findings from the Chamber's 2020 Proxy Season Survey show public companies are prepared to participate in the new SEC process, specifically welcoming the ability to "review and comment" on draft proxy advisory firm recommendations and confirming it would not cause delays or confusion. The new SEC rule takes on more importance given that the survey also found that responsiveness and transparency of proxy advisory firms continue to decline, and conflicts of interest still largely exist.

ACTION: The SEC should prioritize implementation and enforcement of the rules finalized on July 22, 2020, to ensure transparency and accountability for proxy advisory firms.

ACTION: The SEC should submit reports to Congress regarding the impact of its policies for eliminating conflicts of interest by proxy advisory firms, assessing policies and procedures at proxy advisory firms for preventing false statements or omitting a material fact, and examining whether additional protections would be helpful to investors. This concept is embodied in the bipartisan Corporate Governance Fairness Act (S. 3614–115th).

ACTION: Congress should enact legislation that would codify the regulations of proxy advisory firms finalized by the SEC in July 2020.

DOL: UPDATE FIDUCIARY DUTIES REGARDING PROXY VOTING AND SHAREHOLDER RIGHTS

The Department of Labor (DOL) released a proposal in August 2020 to address the application of the prudence and exclusive purpose duties under Employee Retirement Income Security Act of 1974 with respect to proxy voting and exercises of other shareholder rights. The proposed proxy rule, which seeks to eliminate confusion over sub-regulatory guidance and letters the DOL has issued over the years regarding voting proxies, would ensure that fiduciaries are voting proxies only where it is financially in the interest of the plan. This proposal will strengthen investor protection and promote the interests of retirees. Along with recent actions taken by the SEC, the DOL's proposal will ensure that proxy voting is directly tied to the economic return for retirees and follows a transparent and unconflicted process.

ACTION: Policymakers should support the proposed regulatory action on proxy voting under ERISA established plans.

SUPPORT PUBLIC COMPANIES' FLEXIBILITY TO ISSUE DIVIDENDS AND REPURCHASE SHARES

In addition to providing essential goods and services, public companies have an essential role in wealth creation and income generation for everyday American investors that most people don't think about. Each quarter, U.S. publicly traded companies pay out billions in dividends to Americans. A dividend is a distribution of a company's profits to shareholders, including pension plan beneficiaries, 401(k) savers, or everyday investors. Many savers, who may be retired or are no longer working, depend on dividends as a reliable, steady stream of income—which is increasingly important during times of crisis. According to the Federal Reserve's *Report on the Economic Well-Being of U.S. Households in 2016*, income received through interest, dividends, or rental income was received by 27% of respondents over the age of 18. More than one in three (40%) of those 60 or older reported dividends as a stream of income. In fact, for some households, dividends help pay for essential expenses like mortgages or healthcare—both top priorities during a crisis, like the COVID-19 crisis we now face. But still, some policymakers are calling for public companies to be prohibited from distributing dividend payments to their shareholders.

ACTION: Policymakers should allow public companies to continue engaging in dividends and buybacks so they can maintain an efficient capital structure that permits them to finance their growth and share earnings with investors.

SUPPORT SEC REFORMS TO THE SHAREHOLDER PROPOSAL PROCESS

Under the Exchange Act of 1934, Rule 14a-8 establishes the eligibility requirements a shareholder must satisfy to submit a proposal for inclusion in a company's proxy statement. Until recently, shareholders could make a short-term, nominal investment in a company and thereby have free reign to push a proposal unrelated to the company's bottom line performance. These rules had not been substantially updated since 1954 until the SEC modernized them via a rulemaking that was finalized in September 2020.

In 1997—under the leadership of Chairman Arthur Levitt, who was appointed by President Clinton—the SEC proposed raising the resubmission thresholds under Rule 14a-8 so that proposals would have to elicit meaningful support before being proposed again. As the SEC stated then, "We believe that a proposal that has not achieved these [proposed] levels of support has been fairly tested and stands no significant chance of obtaining the level of voting support required for approval."

The commonsense reforms finalized by the SEC to 14a-8 will protect shareholder value without stifling the voices of serious investors. The amendments update the criteria, including the ownership requirements, that a shareholder must satisfy to be eligible to have a shareholder proposal included in a company's proxy statement and modernize the levels of shareholder support a proposal must receive to be eligible for resubmission.

ACTION: Policymakers should implement changes to Rule 14a-8 that were finalized by the SEC in September 2020.

CONGRESS: REPEAL REQUIREMENT FOR INCENTIVE COMPENSATION RULEMAKING

Section 956 of the Dodd-Frank Act requires that financial regulators issue joint rules or guidelines to require financial institutions to disclose to the appropriate federal regulator the structure of all incentive-based compensation arrangements offered. An overly broad joint rule was proposed in 2016 that presented a number of issues and went beyond the intent of Congress, but was never finalized. At the time, the Chamber argued that the rule should use a principles-based approach instead of a one-size-fits-all approach for all financial institutions, including nonbank financial institutions, raised concerns that the rule could dilute human capital, and objected to the onerous compliance burdens required. Financial regulators have been unable to reconcile the flawed requirement from Congress and therefore never finalized the rule.

ACTION: Congress should repeal Section 956 of the Dodd-Frank Act.

SEC: MODERNIZE REGULATION S-K ITEMS 101, 103, AND 105

Regulation S-K lays out reporting requirements for various SEC filings issued by public companies in the U.S. Reporting of information to investors by issuers is premised on the concept of materiality to ensure that relevant information is disclosed but also to limit an over-abundance of extraneous information irrelevant to the performance of a public company. Furthermore, disclosure of nonmaterial information imposes costs on public companies while providing little if any benefit to shareholders.

Prescriptive disclosure requirements, instead of a principles-based approach tailored for individual circumstances, is one of the many challenges facing public companies.

In August 2020, the SEC adopted a rule to modernize elements of Regulation S-K that have not undergone revisions in over 30 years. The amendments to modernize the description of business (Item 101), legal proceedings (Item 103), and risk factor disclosures (Item 105) are intended to improve the quality of disclosure while also discouraging repetition and avoiding disclosure of nonmaterial information.

ACTION: Policymakers should take additional steps to ensure that disclosure requirements for public companies exclusively cover information that is material to investors.

FASB AND SEC: REFORM ACCOUNTING STANDARDS PROCESS

Historically there has been a lack of transparent communication and coordination among regulators, standard-setters, and market participants. A Financial Accounting Forum (FAF) should be created with the mission to identify and propose solutions to problems before they reach the crisis stage. It should be composed of the SEC, Financial Accounting Standards Board (FASB), Public Company Accounting Oversight Board (PCAOB), investors (broadly defined), and businesses. An FAF will also provide a mechanism to allow for appropriate coordination among regulators and input from investors and businesses. This concept was put forward in Section 7417 of the original House-passed version of the Dodd-Frank Act but did not become law.

ACTION: Congress should enact Section 7417 of the original House-passed version of the Dodd-Frank Act to create a Financial Accounting Forum.

SEC: ADDRESS ABUSES OR UNLAWFUL ACTIVITY RELATED TO SHORT SALES

Short selling undoubtedly serves a valuable market function, and a free market should allow investors to go either “long” or “short” depending on their view of a particular company or overall investment strategy. However, the SEC has also noted that market manipulators can engage in abusive forms of short selling that unduly harm investors or the reputation of a company. For example, “short and distort” campaigns occur when a manipulator shorts the stock of a particular company, then spreads false or unverified rumors about the company in order to drive down its stock price, which benefits the short seller.

There are extensive public disclosure obligations for investors who bet on a company's performance by "going long" and buying a company's stock. In comparison, investors are not required to disclose if they take a short position on a company, including via derivatives, to enable a profit due to a decrease in the value of a company's equity.

ACTION: The SEC should remain vigilant in taking action against manipulators who unlawfully engage in activities that harm the overall markets.

CONGRESS: REPEAL NON-MATERIAL DISCLOSURE REQUIREMENTS FOR PUBLIC COMPANIES

For more than eight decades, materiality has been the lodestar of the public company disclosure regime under the federal securities laws. The longstanding materiality standard—namely, what is important to a reasonable investor focused on investment returns—has instilled in investors and issuers alike a confidence in the accuracy and integrity of information that promotes market efficiency, competition, liquidity, and price discovery.

In 1975, the SEC described its views on materiality noting, "As a practical matter, it is impossible to provide every item of information that might be of interest to some investor in making investment and voting decisions. . . . [C]ertain types of disclosure might be so voluminous as to render disclosure documents as a whole significantly less readable and, thus, less-useful to investors generally. In addition, disclosure to serve the needs or desires of limited segments of the investing public, even if otherwise desirable, may be inappropriate, since the cost to registrants, which must ultimately be borne by their shareholders, would be likely to outweigh the resulting benefits to most investors."

In recent years, however, a variety of groups have zeroed in on SEC disclosures by pressing for new mandatory disclosure requirements to advocate for social and political change. While these may be important causes, they are not material to investors and their voting decisions. Unfortunately, the Dodd-Frank Act included a number of nonmaterial disclosure requirements for public companies and new legislation is often introduced in Congress requiring public companies to disclose information that is not material to investors.

ACTION: Congress should enact legislation that repeals requirements for public companies to disclose non-material information to investors. Congress should repeal three sections of the Dodd-Frank Act: Section 1502 (relating to conflict minerals), Section 1503 (relating to mine safety), and Section 1504 (relating to resource extraction).

SEC: HARMONIZE THE PRIVATE OFFERINGS REGIME

Securities offerings are required to be registered with the SEC unless they qualify for one of the exemptions to the Securities Act of 1933, such as issuances under Regulation A and Regulation Crowdfunding. These exemptions make it easier for smaller companies to raise capital without undermining investor protection. The private placement regime under the Securities Act is a patchwork of regulatory exemptions and market practices that have developed over many decades in response to statutory provisions, case law, economic developments, periodic acts of Congress, and a gradual evolution of the Commission's thinking about each of these regulatory exemptions and market practices.

The Commission proposed a rule in March 2020 that would harmonize the exempt offering regime such as permitting issuers to more easily switch exemptions depending on their circumstances, increasing offering limits, clarifying rules for communication with investors such as interactions via "demo days," and updating disclosure requirements. In October, 2020 the Commission finalized this proposal, thus harmonizing the exempt offering framework and making it easier to raise capital in the private markets.

ACTION: Policymakers should support the SEC's October 2020 rule and increase opportunities to raise capital in the private markets.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD REFORMS

The PCAOB was established by the Sarbanes-Oxley Act to oversee the auditing profession for the private sector. The PCAOB is a nonprofit corporation intended to ensure that auditors provide an unbiased opinion on whether financial statements and related disclosures are fairly stated in all material respects in accordance with Generally Accepted Accounting Principles (GAAP). This regulatory structure helps provide more certainty to investors, but also creates some unnecessary issues for audit professionals and new costs for public companies.

PCAOB: ISSUE A POLICY STATEMENT ON THE EVALUATION OF AUDITOR JUDGEMENTS

The PCAOB should issue a policy statement on how it evaluates an auditor's adherence to the auditing standards in complex areas requiring significant judgment on both integrated and financial statement-only audits. Improving communication with the audit profession by issuing a policy statement will help auditors document their judgments.

The SEC Advisory Committee on Improvements to Financial Reporting (CIFiR) has recommended that "the PCAOB develop and articulate guidance related to how the PCAOB, including its inspections and enforcement divisions, would evaluate the reasonableness of judgments made based on PCAOB auditing standards." CIFiR also stressed that the PCAOB should look to SEC policy in evaluating the appropriateness of accounting judgments as part of an auditor's compliance with PCAOB auditing standards.

ACTION: The PCAOB should issue a policy statement on auditor judgments.

PCAOB: IMPROVE CONSISTENCY IN THE INSPECTION APPROACH

The PCAOB inspection process oftentimes lacks consistency. This can be attributed to deficiencies in the standardization of its inspection process due to disparities in guidelines and training made available to inspectors. Furthermore, this may be exacerbated when audit firms, and their clients, are uncertain about how they will be judged because they are trying to anticipate expectations based on past experiences rather than established guidelines. The lack of standardization could also permit identical audits to fail based on who is conducting the inspection.

ACTION: The PCAOB should increase involvement by its Board in oversight of inspections and enhance the post-implementation review program.

PCAOB: HASTEN THE AVAILABILITY OF INSPECTION FINDINGS

The PCAOB should expedite feedback it provides to audit firms. Timely feedback is invaluable for audits involving novel business practices or the employment of new auditing practices to review implementation of new accounting standards, for example. Without timely feedback, auditors may be informed of deficiencies in their practices after completing dozens of audits, when these problems could have been corrected by the PCAOB much sooner. The lack of timely feedback may therefore make it more difficult for auditors to deviate from standardized practices even if it would improve the audit quality. Furthermore, oftentimes the firms have already corrected the noted deficiency by the time the audit report is made public, so the headlines are reporting news about a firm's processes that is no longer current and therefore inaccurate.

ACTION: The PCAOB should expedite feedback it provides to audit firms via inspection findings or another communication framework.

PCAOB: MAKE STRUCTURAL REFORMS TO THE STANDING ADVISORY GROUP

The PCAOB should make structural reforms to its Standing Advisory Group (SAG) to improve the quality of advice provided. The SAG was convened by the Board to advise on the development of auditing and related professional practice standards. Its membership includes auditors, investors, audit committee members, public company executives, and others such as academics. The broad representation of the group causes it to lack a clear focus or direction for advising the PCAOB. The SAG meets two or three times a year and is chaired by the PCAOB chief auditor and director of professional standards. Unfortunately, the deliberations of this body are not as transparent as they could be, and status updates regarding recommendations are not clearly communicated.

ACTION: The SAG should formalize a mission statement describing its purpose, objectives, and processes for assisting the Board in improving its oversight of the audit profession.

ACTION: The SAG should formalize representation parameters (e.g., number of auditors, academics, investors) to ensure a balanced perspective.

ACTION: The SAG should increase the transparency of its deliberations beyond live webcasting of its meetings. It should issue minutes and a transcript of each meeting to make information more available to the public.

ACTION: The SAG should publicly issue recommendations to the Board on an annual basis that will improve oversight of the audit profession. The Board should respond in writing explaining their decisions to accept or not accept recommendations.

ACTION: The PCAOB should use subsets of the SAG or create new advisory groups focused on defined groups of stakeholders and/or issues to inform the Board on matters of importance. A Business Advisory Group would help the PCAOB better appreciate business operations and the impact of PCAOB activities on businesses. An Audit Advisory Group would more substantively allow the expertise and experience of practicing auditors to inform the PCAOB's activities and initiatives, and potentially field-test new standards to assess their effectiveness prior to implementation.

PCAOB: IMPROVE INSPECTION ARRANGEMENTS WITH FOREIGN REGULATORS

Foreign firms accessing U.S. capital markets may use foreign auditors in their home jurisdiction to audit their financial statements. In some cases, the PCAOB is restricted from inspecting the audit work and practices of PCAOB-registered accounting firms in certain jurisdictions, such as China and Hong Kong.

The absence of agreements could prevent U.S.-listed companies from being able to file consolidated financial statements with the SEC or prevent foreign companies from accessing U.S. capital markets. If audit firms operating in foreign jurisdictions do not comply with SEC standards, such as making audits available for review by the PCAOB, their work may be deemed unsatisfactory for establishing if financial statements are suitable for use by investors. Similarly, the SEC may support removing foreign companies from U.S. exchanges if the PCAOB is unable to review the audit of its parent company. These are lose-lose outcomes that would limit opportunities for investors and reduce the flow of capital in the global economy.

ACTION: The PCAOB and SEC should enter into agreements with all foreign regulators that oversee companies accessing U.S. capital markets. Completion of new agreements should be prioritized by the total market capitalization of jurisdictions that currently do not have an agreement with the U.S.