

On the Optimality of Shareholder Control: Evidence from the Dodd-Frank Financial Reform Act

Comments by Daniel L. Chen

Dodd Frank

- Changed proxy access rule permitting shareholders to nominate representatives to corporate boards in opposition to management's nominees
- Give more direct control to shareholders
- Prior to this, they had to distribute their own proxy materials, a costly and time-consuming process (millions of \$)

Theory

- Shareholders monitoring management can mitigate agency problems -> raise firm value
- Shareholders have less information -> lower firm value

Empirics

- Empirical Test needs exogenous variation in control rights
- 3 Natural Experiments involving the SEC's proxy access rule

Identification Strategy

- Event study relies on surprise
- But Business Roundtable proposed threshold of 5% on 1/2007
- Collective holding of 3% threshold proposal suspended on 10/4/10

Investor Expectations

- Status Quo: no proxy access
 - SEC might not have had the authority
 - Announcing a 5% threshold might confirm an intent to have some shareholder control
 - This could have the biggest impact for firms with activist investors
 - Leading to the opposite conclusion: **increasing access has a negative effect**
 - This could be most important for big firms with activist institutional investors
 - Might this explain opposite sign in prior studies? Negative returns with anticipation of passage of proxy access

Identification

- SEC rule was: 5, 3, 1% if firm's market cap was < 75, 75-700, >700 mill
 - Are the coefficients statistically significantly different?
 - Why not regression discontinuity?
 - Why no pre-period check for trends?
 - What are the level effects' T stats?
 - Shouldn't the level effects be opposite on 6/16 and 6/24, but they're both positive – which leads me to wonder about investor expectations

Identification

- How are standard errors clustered? Are the firm returns really i.i.d.? Within-industry correlation, etc.?
- Control for activist institutional investor characteristics (more concentrated positions, higher turnover)?

Identification

- Rule 2: Collectively own 3% for minimum of 3 years, only for firms whose 2010 proxy statement was mailed after a certain date
 - Private information: Do traders know about other traders' holding positions, periodicity, date of last proxy ballot?
 - Who's doing the buying? The investor's themselves?

Measurement of Optimality

- Stock Price as measure of optimality
- Could it be evidence of the preferences of identified activist shareholders?
 - They like to own shares where they get to be active and more shares where they get to be more active
 - Activist shareholders might want to increase their holdings and reallocate from companies where they couldn't or weren't interested in being active
 - Check for holdings change?
 - Though prices may move in a manner preventing much change

Collective 3% threshold

- Which part of news was surprise? Was the collective part a surprise?
 - If investors thought 3% for 2-3 yr hold, then collective 3% for 3 yr hold makes it both harder for 2-3 yr and harder for 3 yr group if there are coordination problems
 - Difficult to interpret

Market Efficiency

- Should we see people putting \$ into SharkWatch50 investors because they're better able to monitor managers efficiently?

Suspension of Rule

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In the Matter of the Motion of

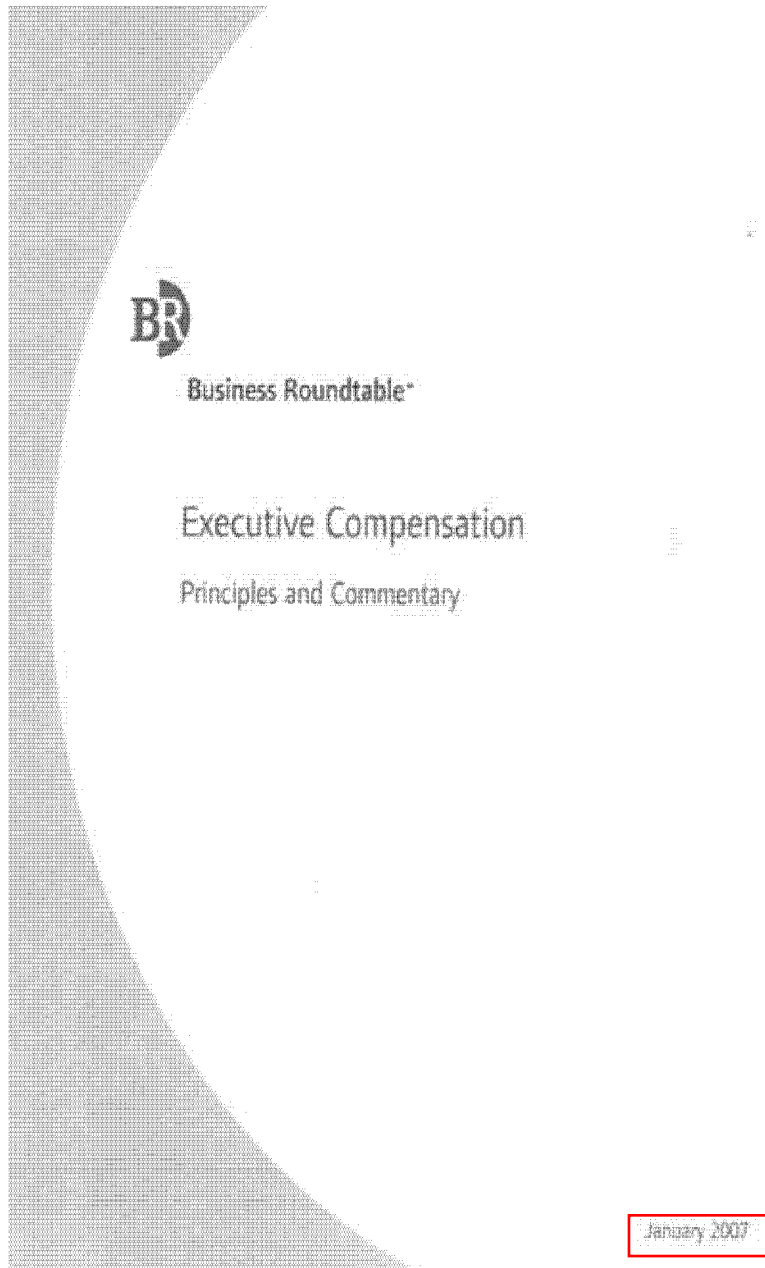
**Business Roundtable and the Chamber
of Commerce of the United States of
America**

**For Stay of Effect of Commission's Facilitating
Shareholder Director Nominations Rules**

ORDER GRANTING STAY

EXHIBIT IV

EXECUTIVE COMPENSATION: PRINCIPLES AND COMMENTARY (JANUARY 2007)



A.6. Business Roundtable believes that a Federal proxy access right is unnecessary and would have serious adverse consequences, including promoting an unhealthy emphasis on short-termism at the expense of long-term value creation, facilitating the election of “special interest” directors, increasing the frequency of contested elections and discouraging qualified directors from serving on corporate boards. Therefore, we do not support a Federal proxy access right. If Congress moves forward in this area, Business Roundtable believes that proxy access should be available only to holders of a significant, long-term interest in a company. Accordingly, we believe that the stock ownership threshold for individual shareholders seeking to place nominees on company proxy statements should be 5 percent of a company’s outstanding voting stock and that the threshold for shareholders aggregating their shares should be 10 percent. In either case, a “net long” ownership position—that is, full voting and investment power with respect to the shares in question—should be required.

In addition, we believe that proxy access should be available only to shareholders who have demonstrated a commitment to a company and its business. Accordingly, we believe that shareholders should have to satisfy the relevant stock ownership threshold for a period of at least 2 years before they can nominate a director for inclusion in the company’s proxy statement. Any shorter holding period would allow shareholders with a short-term focus to nominate directors who, if elected, would be responsible for the creation of long-term shareholder value. In addition, we believe that shareholders should have to continue to satisfy the relevant ownership threshold not just through the annual meeting at which their nominees are elected, but for the duration of the nominees’ service on the board or at least through the term for which they nominated the director.

Q.7. What are issues that shareholders should have an opt out or opt in vote on?

A.7. As discussed above in the answer to Question 1, we do not believe that an “opt in” or “opt out” vote on different governance practices is necessary because shareholders already have the ability to communicate their views on whether to adopt particular practices. As an alternative to this approach, Business Roundtable supports enhanced disclosure about companies’ corporate governance practices. For example, the SEC recently proposed rules that would require annual proxy disclosure about a company’s leadership structure and why the company believes it is the best structure for the company, including discussion about whether the company combines or separates the roles of chairman of the board and CEO and whether the company has a lead independent director. Similarly, Business Roundtable would support a “comply or explain” approach, which some non-U.S. markets already follow, that would require companies to disclose whether they have adopted specific governance practices, and if not, why not. Either of these alternatives would allow companies and shareholders flexibility in determining the practices that are most appropriate for them, provide transparency to shareholders and avoid a “one-size-fits-all” approach.