Columbia Law School

Millstein Center for Global Markets
and Corporate Ownership

SESSION BRIEF NO. 7

Key Topics in Corporate Governance:

Symposium on Disclosure

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About the Millstein Center for Global Markets and Corporate Ownership

Building on Columbia Law School's longstanding strength in corporate and securities law, the mission of the Millstein Center for Global Markets and Corporate Ownership is to bring world class scholarship, research and academic rigor to the vital task of restoring and strengthening long-term financing of innovative and durable public corporations, which are the underpinning of economic growth.

This mission is essential given today's capital markets which are global, complex and volatile, and bring consequences and uncertainties to those who rely on them: companies, investors, and ultimately the wider economy.

The Center's research on the capital market and its impact on corporate governance and performance builds upon the work of the earlier successful "Institutional Investor Project" at Columbia University (1986-94), as well as the successes of the Millstein Center for Corporate Governance and Performance at the Yale School of Management (2005-12). The value of the Center's research is enhanced through active engagement with practitioners.

This paper provides a brief summary of discussion points, presentations, and findings from the "Key Topics in Corporate Governance: Disclosure" Symposium held in June 2015.

The Center's Session Briefings are framed as concise summaries of events or reports designed to promote policy discussion or further research. They strive to encompass a diversity of perspectives and are based on a combination of presentations, independent research, and the experiences of market leaders and thought leaders who participate in Center events or workshops. Participants generally include corporate board members and managers, institutional investors, advisors, leading academics, regulators, and other thought leaders.

Marcel Bucsescu, Executive Director of the Millstein Center served as lead editor. Jonathan Kim, former Senior Vice President, General Counsel and Secretary of Montpelier Re Holdings Ltd., and Rosemary Dodemaide, Operations Coordinator of the Millstein Center, served as secondary editors. Allison Mitkowski of Little Foot Communications served as the reporter.

The Millstein Center is extraordinarily grateful to all of its sponsors and partners, which provide support on an ongoing basis (a list of supporters can be found on the Center's website).

We would also like to extend a special Thank You to Deloitte for their collaboration, contributions, and participation in this event.

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On June 18, 2015, the Ira M. Millstein Center for Global Markets and Corporate Ownership hosted a symposium on transparency in the corporate and investment communities. The half-day event brought together prominent speakers from the business, regulatory and academic sectors to discuss current trends and emerging issues associated with disclosure. In a related vein, panelists also debated the case for furthering engagement with retail investors whose needs and resources may differ, at times substantially, from their institutional counterparts. The following is a summary of the panel discussions.

Disclosure is a heavily-discussed and oft-debated topic among corporate governance professionals and regulators as well as corporations and investors. At the 2015 symposium, thought leaders convened to dig deeper into the topic in an effort to determine what standards and expectations are practical for various stakeholders and the direction in which current trends are headed.

How Much Disclosure and What Kind?

The first panel focused on the effectiveness of disclosure by corporations. To be clear, the starting proposition was not whether disclosure is needed. Most stakeholders would readily agree that it's essential—no matter how cumbersome the process may be. The level and nature of disclosure warranted, however, remains the topic of an ongoing debate. The goal of the panel was to focus on the appropriate degree of disclosure for investors and related stakeholders—a question which evokes few easy or consistent answers given the diversity of views that exist within that community. There is no one-size-fits-all model, the panel acknowledged, so companies must solve the difficult equation of how much information to disclose and how to disclose it.

Building on the disclosure theme, the panel also agreed that investors want more engagement with companies, but currently lack mechanisms to adequately foster such engagement. The primary mechanism remains a company's mandatory regulatory reports and marketing disclosures; however, this is often rendered ineffective due to the impracticality of disclosure documents such as prospectuses and SEC filings. The disclosure dilemma lends a sense of urgency to the debate about disclosure effectiveness, since investors rely on the information available to them in order to guide their investment decisions. Some companies are paving the way for transparency on a voluntary basis, which one panelist said is better suited to disclosing the types of information that investors deem critical. The difficult part for companies is determining what information is considered critical and what may be deemed potentially useful or even non-essential when it comes to assisting investors in their quest to make "informed" investment decisions.

The panel agreed on the difficulty in finding a middle ground with investors as a group since opinions around disclosure effectiveness vary widely from investor to investor. Because investors increasingly have different strategies and priorities, it is nearly impossible for them to rely on regulated disclosures such as periodic SEC 10-K/Q reports or proxy statements to satisfy their needs. Moreover, one panelist noted that reputable investors have indicated that they simply lack the time to digest all of the information in these mandatory filings as the filings grow in length and complexity to meet increasing regulatory demands and to appeal to broader audiences.

In response, some investors are calling for greater emphasis on executive summaries and more frequent use of illustrative material in these otherwise dense documents. One proposal the panel discussed would include the addition of a one-page cheat sheet at the beginning of the 10-K that highlights key topics within the document in bullet-point format. This cheat sheet would accompany an executive summary of the vast array of information within the filing. This type of layered approach to disclosure would provide investors with more choices for how they want to receive information. For example, the proposal would enable investors to decide if they want to dive deep into the document at the outset; use the cheat sheet to skip to pertinent information; or skim the executive summary for a high-level overview prior to any in-depth analysis.

One panelist noted, however, the potential pitfalls associated with such a proposal. His company had, in fact, experimented with an executive summary previously and had received blowback from investors who felt the company failed to provide enough information. The panelist went on to discuss the company's shift to voluntary disclosure as a mechanism to increase shareholder engagement. The board and management found that while the shift had increased engagement on some levels, reaching a consensus about what constitutes fair and balanced disclosure remained a formidable task. *"I can have five meetings with investors and hear five different things in terms of what investors want us to disclose,"* he said. The panelist added that his company had issued its first Corporate Social Responsibility (CSR) report in the early 2000s and was criticized by many investors who felt the 35-page document was too light. The investors wanted deeper, more granular information, so in response the company filed a longer report (85 pages) the next time around. Investors then reversed course once again, indicating the longer report was too dense, and called for executive summaries instead.

Layered disclosure was a key topic of discussion for the panel. One panelist recommended the de-emphasis of too many details up front or within the bodies of disclosure documents. Such an approach would rely on the appendicies of long and complex filings to allow investors access to comprehensive information without the burden of sifting through pages of material to pull out key facts and figures that are often buried within extraneous information that—while required—may not influence investment decisions. *"Investors do have very different ideas about what is relevant and what is important to their decision-making process,"* the panelist noted. The array of investor needs is exactly the reason why a layered approach would provide companies with the ability to address diverse constituencies with various investment focuses. Some investors, for example, may be concerned about a company's political spending while others consider lobbying expenses less important, or even irrelevant, to their investment decisions. Therefore, the panelist felt that the onus for disclosure effectiveness falls not only on the SEC but also on companies to do a better job of providing clear, concise disclosure that investors can easily navigate.

One panelist acknowledged the value of using technology (mainly the Internet) to host disclosures and to improve the efficiency of such disclosures from an investor standpoint. If a company includes disclosures on its website, investors can search for and find relevant information on a more automated basis, rather than manually sifting through lengthy hard copies of regulatory filings or relying on less user-friendly online tools such as the SEC's EDGAR system, which despite the implementation of XBRL, is still viewed by some as difficult to use. The panelists said they hoped the SEC would eventually give more consideration to allowing companies to use the Internet as a more free-form method of disclosing information relevant to investors that need not be included in formal SEC filings—or, taken a step further, in lieu of such filings. If a company is allowed to place the bulk of its disclosures on its website, or even its Twitter feed, and not within the strict confines of SEC filings, one panelist said that more companies would be willing to migrate disclosures online, as it would limit '34 Act liabilitiy that exists with current SEC disclosures.

The panelist noted that the real question at hand is what information must be included in an SEC filing by law and what information (mandatory or otherwise) could be relegated to the web. If a consensus could be reached on this issue, there would be a clearer understanding among corporations regarding what information would be acceptable to disseminate dynamically via online channels.

The panel closed its discussion on the question of investors communicating directly with board members to address questions or concerns. The consensus among panelists who commented on this topic seemed to lean in favor of spending the time and resources to engage in one-on-one conversations with investors who approach them with a clear agenda and whose input adds value to the communication process.

Disclosure by the Smart Money

The second panel covered the question of disclosure by institutional investors. Discussion centered around transparency in voting, which the panel felt was a topic of importance since share ownership is now increasingly concentrated in the hands of institutional investors. One panelist noted the wholesale shift from a world of dispersed retail investors to a universe dominated by institutional owners, and highlighted that the concentration of institutional ownership is critically important for the business community to understand. The panelist cited research that puts the concentration of institutional ownership at roughly 75% or more of all public shares in the United States.[1] *"Indeed, for some very large firms, if you put as few as 25 of these owners around a table, you will literally be able to have the controlling owners of these firms assembled right before you,"* the panelist said. This evolution of the ownership environment raises important policy questions. And if there is a need for more information on the part of investors, it begs the question of how to balance ownership disclosure with confidentiality.

The current disclosure regime for institutional investors is comprised of several key forms, including forms 13-D, 13-F, and 13-G and form ADV, all filed with the SEC. Some panelists noted, however, that important informational gaps exist in the current structure, including transparency issues in the oft-cited areas of equity holdings and proxy voting.

In response, one panelist commented that there is rarely confusion about their organization's ownership stake in a particular company, or where they stand on particular issues, especially when it comes to voting on a company's proxy proposals. As such, she felt that the current system is adequate—meaning it was performing its crucial role—and that efforts at eliciting additional disclosure on the part of institutional investors seemed more targeted at specific corporate wishes than systemic shortcomings.

Another panelist representing a proxy advisory firm felt that while the current disclosure regime in the U.S. is not broken, there were areas where incremental disclosure would be helpful for investors and the market. He also noted that voting is never fully transparent, even to companies. To determine how shareholders voted on proxy proposals, a company has to hire advisors to help determine who may have cast which vote. The need for companies to understand who is raising an objection, or who is voting against the issue at hand, is useful, he said.[2] As a few panelists explained, this process is more of art than science.

1 The Conference Board, The 2010 Institutional Investor Report: Trends in Asset Allocation and Portfolio Composition (New York, 2010).

2 To give additional context, the speaker compared the process to trading; while brokers can see certain blocks of positions that are trading, they are unable to determine exactly who did or did not place a particular order. In voting situations, one would have to estimate who voted which way based on the institutional holder's past voting history and proxy voting guidelines, if available, and the size of the holder's voting position as noted in the 13-F filing.

The panel also discussed the need for companies to know how their investors are voting juxtaposed with the desire for some investors to maintain confidentiality. One panelist observed that the practice of securities lending, or institutional investors borrowing shares, is also relevant in a voting context. While the panelist did not have strong objections to this practice—which can be done for legitimate purposes—there is also room for abuse, or so-called "empty-voting". Empty-voting can occur when securities firms lend shares they manage on behalf of retail investors to institutional investors or hedge funds in exchange for fees. Voting rights are lent with the shares, and as a result there can be confusion over how many shares a particular investor (retail or institutional) owns versus how many shares it is (or isn't) holding as of the proxy record date for the purposes of shareholder votes. Short-term speculators and other outside interests may use this tactic to mask their voting power within a company in order to influence voting in their favor while long-term investors may be unaware that their shares and their associated voting rights have been "borrowed" from their accounts until after all votes have been cast. In this example, when the voting power of a company's shareholders is unclear, it becomes more difficult for the company to have meaningful engagement with its true owners.

A panelist representing an activist investor commented that calls for increased disclosure by institutional investors have resulted from a rise in shareholder activism. The panelist commented on a proposal that seeks to amend the 13-F (holdings of institutional investment managers) disclosure requirements. Proposed changes include requiring monthly rather than quarterly reporting, and shortening the reporting deadline from 45 days to two business days after the quarter ends. The panelist said the changes would allow the market to know when an investor is acquiring shares earlier in the process—and more importantly, before the investor has acquired their target position. The panelist commented that this would have a negative affect on shareholder activism, and he raised the question of whether or not the proposed changes would be fair to others, given the existence of schedule 13-D (changes in beneficial ownership) reporting requirements. *"Ultimately, my view is that I would encourage people to avoid these zero-sum approaches and seek out opportunities to get the same result through best practices and collaborative efforts,"* he said, adding that there are other ways to achieve the goals of the organizations that are proposing the 13-F changes. Alternatively, it was proposed that companies should be encouraged to engage more deeply with their investors and to focus on their strategic plan; discuss the plan with investors; ask for feedback; and then communicate it broadly and aggressively.

Another panelist commented that engaging with shareholders is vital to a company's health—not just in the context of proxy contests, but in regard to building and maintaining ongoing relationships with investors. Many companies, particularly large and mega-cap, have staff dedicated to investor relations as well as corporate governance matters. It was noted, however, that many institutional investors do not have similar dedicated resources, often making engagement difficult. The panelist requested that institutional investors designate a specific individual(s) for corporations to reach out to regarding engagement.

Reaching out to Mom & Pop

The final panel discussion examined retail investors and the role they can play in governance issues, particularly in proxy voting situations. The panel acknowledged that this topic does not get much attention, which is surprising given retail investors may comprise as much as 30% or more of a company's total investor base. The panelist noted that, on average, 20% of a company's shares are not voted in any given proxy contest, leaving a sizable gap of voters who could make a difference in the outcome of a close vote. Research shows that retail investors tend to vote in favor of management, so some companies are increasing their communication efforts to engage retail investors on a more meaningful level.

Knowing your audience when it comes to retail investors is critical because there is such a wide range of people—from senior citizens to Millennials—who are playing in the retail space. The opportunity to engage with retail investors is ripe for the picking, and smart companies are recognizing and capitalizing on this opportunity. Some companies are implementing targeted email communication with successful results. One panelist said that response rates for issues-based emails (sent from the office of the CEO) tend to generate a response rate of 50% or more within just a few days of distribution. The panelist commented that technology is a game-changer for companies looking to increase engagement with retail investors. Done correctly, it was observed that this paradigm shift could disrupt the governance debate, and could potentially counter-balance the concentrated power of institutional investors.

Where to Next?

Ultimately, the day's panel discussions may have raised more questions than answers. Nevertheless, the speakers' remarks clearly indicated that such questions are important to examine. Understanding the changing nature of investors—both institutional and retail—and the implications for companies is not a new endeavor. Yet critical gaps in understanding remain that leave all parties to the investment chain working with educated guesses at best and making incorrect assumptions at worst. If disclosure and engagement are approached with a win-win mindset, our corporations, investors, markets, and economy will all be better served by the interactions.

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