Will the SEC take on the shareholder proposal process?

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The swearing-in of Hester Peirce and Robert Jackson on Jan. 11 gave the Securities and Exchange Commission a full slate of commissioners for the first time in nearly two years. Now that it is at full strength, it is worth asking what ought to be the SEC's priorities for the immediate future. Allow us to make a suggestion: It ought consider how to fix a badly broken shareholder proposal process.

Congress created the SEC following the market crash of 1929 with three main objectives in mind: to protect retail investors; maintain fair, orderly, and efficient markets; and facilitate capital formation through the creation and listing of new securities. For the first 60 years of its existence, the SEC was largely successful in this regard, helping U.S. financial markets become the envy of the world.

Unfortunately, that leadership position has begun to erode over the past two decades, as companies are increasingly hesitant to subject themselves to the vicissitudes of the stock market for a variety of reasons. Instead, they remain in the hands of wealthy investors in one form or another.

The SEC needs to act soon because the consequences of this decline continuing are serious, both to the U.S. economy and to those of us trying to save to pay for retirement and college.

Today, more and more potential public companies are raising capital privately, mostly from high net worth individuals and sovereign funds. This deprives retail investors of the opportunity to participate in and potentially benefit from often significant growth that good companies, selling great products and ideas, experience in their initial post-IPO run.

The average total return for initial public offerings stood at 23.1 percent in 2016, and the average total return of IPOs has surpassed 20 percent in four of the last five years, reaching as high as 40.8 percent in 2013.

Given that retail investors tend to put most of their retirement savings in equity markets, their inability to capitalize on this growth is problematic. As the number of IPOs dwindles, returns from equity investments effectively shift from Main Street investors to private equity, sovereign funds, and wealthy individuals.

To the extent that the current shareholder proposal process acts as a deterrent to IPO activity — and few dispute that it certainly does — it needs to be fixed as soon as possible.

One thing that specifically needs to be addressed is the stock proxy proposal process. Shareholder proposals have played an important role over the years in promoting and drawing attention to a number of worthy priorities. Over the past decade, proposals aimed at enhancing corporate governance standards and ensuring objective directors have improved the performance of many corporate boards and helped to focus senior management across the Fortune 500.

But somewhere along the way, the proposal process gradually morphed from one focused on genuine value creation to something today that's anything but. A decade ago, the vast majority of shareholder proposals submitted dealt with issues such as classified boards, option repricing, and board entrenchment tool-like poison pills.

However, according to data compiled by the Conference Board, 43 percent of proposals brought to shareholders at Russell 3000 companies this past proxy season focused on promoting political or social causes. The result: increased corporate costs, a decrease in time that management spends on the underlying business, and an uneven playing field when it comes to competing against private companies and those listed on foreign exchanges.

Proposals looking to promote personal agendas, or demanding changes that have little to do with the core business of the targeted company, were supposed to be excluded under previous guidance provided by the SEC. Unfortunately, proponents have found a way around these exclusions by recasting them as a form of disclosure. Closing this loophole would be a good start.

Additionally, the SEC must strengthen requirements for who can bring a shareholder proposal; it should hold firm on how often a failed proposal can be resubmitted at the same company; and it needs to rein in proposals on additional disclosures, so that companies are not forced to spend millions of dollars responding to any hypothetical situation shareholders of any size can possibly conjure.

There are fewer listed companies in the United States today than there were in 1976, despite the fact our GDP today is three times greater. If the listing process puts U.S. companies at a disadvantage to foreign competition by adding an unpredictable regulatory layer of costly shareholder proposals, these numbers will continue to decrease. And the status quo will continue to exclude Main Street investors from participating in the growth of our best, newest, and most innovative companies.

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