**WRITTEN TESTIMONY TO THE ECONOMIC MATTERS COMMITTEE,
MARYLAND HOUSE OF DELEGATES**

HB 0589

"CORPORATE BYLAWS AND ELECTION OF DIRECTORS AND TRUSTEES"

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Chair Davis and Members of the Committee: Thank you for this hearing and your attention to the matters raised in HB 0589, introduced by Delegate Frick. I want to express appreciation to Delegate Frick and co-sponsors of HB 0589.

I am Executive Director of the Council of Institutional Investors. The Council was organized in 1985 by public and other pension funds to promote shareholder rights, strong corporate governance, investor protection and capital market practices that would sustain long-term shareholder value and the interests of pension beneficiaries. Today we represent asset owners with about $3 trillion in assets, and we have asset manager associate members with about $20 trillion in assets under management.

The Council is a "broad tent," and our members have a wide range of views on many issues of concern to investors. However, a majority vote standard for election of corporate directors is NOT one of those issues. Our members are agreed on this: there should be a majority vote standard in election of directors.

- The voting policy of the Maryland State Retirement and Pension System in this respect is typical for our members: "Directors should be elected by a majority of the shareholders casting votes."

- Similarly, the T. Rowe Price policy is typical for investment managers on this issue. The guidelines indicate that "majority voting has the potential to substantially improve the U.S. system for electing corporate directors, increasing their accountability to shareholders. We believe directors should relinquish their board seats if they are opposed by a majority of their shareholders." In fact, the T. Rowe Price policy provides that it may oppose a director who fails to remove a fellow director who received less than a majority of shareholder support the prior year.

When shareholders are given the opportunity to vote on whether a company should use a majority vote standard in election of directors, they strongly support it. On average, 73 percent of shares voted supported implementing majority vote standards in shareholder proposals voted on in 2016, despite opposition by management. There were 89 board-sponsored proposals at U.S. companies to implement majority vote standards in 2013-16, and these proposals won support from an average of 98 percent of shares voting.

Boards of directors play the key role in corporate governance, and their accountability to owners is essential to protect investors, including state and local pension funds. We believe strongly that accountability creates better business performance, and that lack of accountability eventually leads to abuse and poor performance that is costly to shareholders and to the economy.

The plurality vote standard that predominated in the United States before the Council and our members began advocating for a majority vote standard 12 years ago undermines board accountability that is essential for well-functioning public company capital markets. Currently, nearly 90 percent of S&P 500 companies use a majority vote standard, although just three of 10 companies in the small-cap Russell 2000 do so.

In the vast majority of director elections, the board nominates a slate of directors that runs unopposed. Under a plurality standard, those nominees will be elected with support of as little as one shareholder, even if a majority of shares are "withheld" or voted "against."

To protect investors, including state pension funds, corporate board members who fail to win a majority of shares voted in an uncontested election should step down. If an individual cannot win 50 percent essentially running against himself or herself, there is a problem. In fact, directors the vast majority of cases win re-election with very strong majorities. Most boards do good jobs, and shareowners are inclined to defer to boards except where investors have a conviction that something is seriously wrong. Directors in thousands of uncontested elections averaged support from more than 96 percent of shares voted in 2016. Just 47 in the Russell 3000 failed to receive majority support, and these failures affected only 28 companies, less than 1 percent of the index.

Boards retain most directors who fail to win majority support, nullifying the election results and corroding a sense of accountability to share owners more generally. Only 25 percent of directors failing to receive majority support between 2013 and 2016 had departed their board by the end of 2016. A disproportionate number of directors who failed to win majority votes and yet remain on boards are at Maryland incorporated companies.

The American Bar Association Business Law Committee put forward bylaw language for a majority vote standard, the basis for language in HB 0589. The large majority of companies are incorporated in states that either default to a majority vote standard, or require that shareholders may amend the bylaws to institute majority voting (among other shareholder rights), or do both. In contrast, Maryland law does <u>not</u> default to a majority vote standard, and Maryland companies are permitted to have charter or bylaw provisions that prevent shareholders from amending bylaws.

This combination of factors does reputational harm among investors to Maryland as a state of incorporation:

- A disproportionate number of directors who remain on boards despite failed elections are at Maryland companies; and
- Maryland law both defaults to a plurality vote standard AND allows companies to prevent shareholders from amending the bylaws to create and maintain a majority vote standard.

It is not good for capital markets generally, or for Maryland, for the state to have policies that facilitate entrenchment of poor management. The fact is, most of the largest publicly held companies in Maryland have adopted some form of majority vote standard, including the five largest by market cap: Lockheed Martin, Marriott International, T. Rowe Price Group, Host Hotels & Resorts, and McCormick & Co.

The consensus in favor of a majority vote standard in election of directors is expanding, and gaining even more force. In July 2016, a group of business and investment leaders announced the Commonsense Principles of Corporate Governance, articulating key governance priorities, including that “Directors should be elected by a majority of the votes cast ‘for’ and ‘against/withhold’”. This group includes companies such as Berkshire Hathaway, JP Morgan Chase, General Electric and Verizon, and asset managers such as BlackRock, Vanguard, State Street Global Advisors, Capital Group, and T. Rowe Price. Similarly, an Investor Stewardship Group announced in January 2017 stresses the importance of board accountability to shareholders, including through majority vote policies. The group overlaps with those supporting the Commonsense Principles, and includes BlackRock, Vanguard, State Street Global Advisors, T. Rowe Price, TIAA Investments (now Nuveen), Wellington Management and Barrow Hanley.

I strongly support HB 0589, and would be glad to respond to questions on director voting standards and board accountability.