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OPINION

How to Boost Shareholder Democracy

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With the nation's attention riveted on the November election, Washington has turned into a city of lame ducks. Yet just as the Bush administration is winding down, the Securities and Exchange Commission (SEC) is gearing up.

For the first time in more than six months, the SEC has a full complement of Republican and Democratic commissioners, and thus has the ability to act on any number of outstanding issues. The most important of these issues is shareholder access to a company's proxy, or annual voting ballots.

The principle that shareholders own the companies in which they invest – and are the ultimate bosses of those running them – is central to modern capitalism. Over the past five years, the SEC has wrestled with this issue. Last November, the commission amended the rules to prohibit shareholders from putting forth bylaw changes to how company directors are elected. At the time, SEC Chairman Christopher Cox said that this move was just a temporary stopgap until a full commission was in place. Now that one is, it's time to reverse this decision.

The meltdown of the subprime mortgage market, the implosion of Bear Stearns, and the revelations of poor risk management on the part of several large companies has injected a dangerously large degree of mistrust into the markets. Investors rightly are highly skeptical of those who should have raised the alarm, including boards of directors.

While not a panacea, giving shareholders a bigger voice in the companies they own would go a long way in helping to restore trust. It would increase management accountability, and also send a strong signal that this newly replenished SEC is on the side of investors.

At the end of last year, a very different signal was sent. At the time, the SEC was facing a 2006 decision by the U.S. Court of Appeals for the Second Circuit. The court found that a public company must open its proxy to proposals that amended the bylaws concerning the election of that company's directors. This ruling offered shareholders a way to have a say on how directors were elected, without waging a costly and usually fruitless proxy nomination campaign.

After receiving tens of thousands of comment letters, a vast majority of which supported the court's ruling, the SEC decided to effectively roll back the court's decision and rule that these shareholder-access proposals to a company's bylaws could be excluded from the proxy.

This decision was a major setback to shareholders of all sizes, and a disappointment to those who believe that the SEC's mission is to be the investor's advocate. It sent a message that the commission did not take accountability seriously, and undermined its praiseworthy efforts on such important issues as executive compensation.

When this ruling was made, Mr. Cox said that he intended to revisit the issue of proxy access this year, when he had a full complement of commissioners. And there are signs that the SEC acknowledges the importance of allowing shareholder voices to be heard. Earlier this year, for instance, the SEC told several companies, including Boeing, General Motors and United Technologies, that they had to include on their proxies shareholder proposals to adopt principles in support of universal health-care reform. In recognizing this as a significant public policy issue, the SEC demonstrated a flexibility and openness that is encouraging.

I hope that this new SEC undertakes a new rulemaking concerning proxy access immediately. The SEC could put together a full proxy-access proposal that details what is and is not acceptable. Alternatively, it could simply reverse its decision from last December, and leave it to shareholders to decide through votes on their respective companies' bylaws what rules best serve their needs.

To be sure, if not carefully constructed, these rules could harm the ability of companies to run their businesses. That's why it's important that the SEC put in place safeguards to prevent mischief-making. For instance, it should establish a significant, but not onerous, threshold amount of stock one must own to put forward a vote, a framework regarding disclosure and conflicts of interest, and rules that ensure that any changes to a board do not violate stock-exchange listing standards. Over time, a set of best practices on proxy access will emerge, creating pressure for all companies to embrace them.

All 40 of the largest markets outside of our own give shareholders the ability to nominate and remove directors. By reversing its decision from last year, this new SEC will make it very clear that it is not only at full strength, but strongly on the side of investors. It will show the world that the U.S. takes shareholder democracy seriously, strengthening our markets' standing as the world's best. More important, it will reinvigorate accountability, restoring trust in a system badly in need of support.

Mr. Levitt was chairman of the SEC from 1993 to 2001.

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