Via Email

April 16, 2015

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number S7-01-15

Dear Mr. Secretary:

The purpose of this letter is to provide you with the Council of Institutional Investors' (Council) comments on the Securities and Exchange Commission's (SEC or Commission) proposed rule, Disclosure of Hedging by Employees, Officers and Directors (Proposed Rule).[1] The Council is a nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of American workers.[2]

As you know, it is well documented that dramatic failures in corporate governance were a key cause of the financial crisis[3] and improving corporate governance requirements post-crisis would help restore and maintain trust in the integrity of the U.S. financial markets.[4] Congress responded, in part, by enacting Subtitle E of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) entitled Accountability and Executive Compensation.[5]

[1] Disclosure of Hedging by Employees, Officers and Directors, Securities Act Release No. 9723, Exchange Act Release No. 74,232, Investment Company Act Release No. 31,450, 80 Fed. Reg. 8486 (Feb. 17, 2015), *available at* https://www.federalregister.gov/articles/2015/02/17/2015-02948/disclosure-of-hedging-by-employees-officers-and-directors.

[2] For more information about the Council of Institutional Investors (Council) and our members, please visit the Council's website at http://www.cii.org/about_us.

[3] *See, e.g.,* Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report xvii (authorized ed., Jan. 2011) ("We conclude dramatic failures of corporate governance . . . were a key cause of this crisis."), http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[4] *See, e.g.,* Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 22 (July 2009) ("Improved corporate governance requirements would . . . help to restore trust in the integrity of U.S. financial markets."), http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

[5] Public Law 111-203, 124 Stat. 1900 (July 21, 2010), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/content-detail.html.

The stated Congressional intent of Subtitle E was to "empower[] shareholders in a public company to have a greater voice on executive compensation and to have more fairness in compensation affairs."[6] Subtitle E includes Section 955: Disclosure Regarding Employee and Director Hedging.

The Proposed Rule to implement Section 955 has important implications for the Council's long-standing membership approved corporate governance best practices on hedging of compensation.[7] That policy states:

> Hedging: Compensation committees should prohibit executives and directors from hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity based awards granted as long-term incentive compensation or other stock holdings in the company. And they should strongly discourage other employees from hedging their holdings in company stock.[8]

We note that, consistent with our policy, "hedging of company stock is widely considered to reflect poor corporate governance practices . . . ."[9] As a result, approximately fifty-four percent of Russell 3000 Companies and eighty-four percent of large capital S&P 500 companies have prohibited employees from hedging company shares.[10]

For those companies that have not yet fully adopted our policy, we agree that the Proposed Rule would provide our members and other investors with a more complete understanding regarding the persons permitted to engage in hedging transactions and the types of hedging transactions permitted.[11]

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[6] Report of the Senate Committee on Banking, Housing, and Urban Affairs, S. 3217, Report No. 111-176, 37 (Apr. 30, 2010), *available at* http://www.banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf.
[7] Council of Institutional Investors, Corporate Governance Policies, § 5.8d Hedging (Updated Apr. 1, 2015), http://www.cii.org/files/committees/policies/2015/04_01_15_corp_gov_policies.pdf.
[8] *Id.*
[9] Stephen H. Harris & J. Mark Poerio, *The SEC's Proposed Disclosure Rules for Hedging Transactions by Directors, Officers, and Employees*, Paul Hastings LLP 2 (Feb. 27, 2015), http://www.paulhastings.com/publications-items/blog/erisa-and-global-benefits/erisa-and-global-benefits/2015/02/27/the-sec-s-proposed-disclosure-rules-for-hedging-transactions-by-directors-officers-and-employees.
[10] *Id*. at 2.
[11] *See* 80 Fed. Reg. at 8488 ("Disclosure of both categories of prohibited and those permitted conveys a complete understanding of the scope of hedging at the company.").

Armed with the proposed disclosure, our members and other investors would be in a better position to make more informed investment and voting decisions,[12] including voting decisions on proposals to adopt hedging policies,[13] the advisory vote on executive compensation,[14] and voting decisions in connection with the election of directors.[15]

Finally, we believe the proposed disclosure would benefit our members and other investors because the public nature of the required disclosure would result in more public companies adopting our hedging policy and enhancing long-term shareowner value.[16] For all the above reasons, the Council generally supports the Proposed Rule.[17]

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[12] *Id.* at 8501 (We agree with the Securities and Exchange Commission that "[b]etter information about equity incentives could be useful for investors' evaluation of companies, enabling investors to make more informed investment and voting decisions, thereby encouraging more efficient capital allocation decisions.").

[13] *See* Florida SBA 2015, Corporate Governance and Proxy Voting Guidelines 71 ("The SBA generally votes FOR proposals designed to prohibit named executive officers from engaging in derivative or speculative transactions involving company stock, including hedging, holding stock in a margin account, or pledging large amounts of stock as collateral for a loan."), https://www.sbafla.com/fsb/Portals/Internet/CorpGov/ProxyVoting/2015_SBACorporateGovernancePrinciplesProxyVotingGuidelines.pdf; *see also* BlackRock, Proxy Voting Guidelines for U.S. Securities 11 (Feb. 2015) ("We believe that boards should establish policies prohibiting use of equity awards in a manner that could disrupt the intended alignment with shareholder interests, for example: . . . use of the stock (or an unvested award) in hedging or derivative transactions[] [and] [w]e may support shareholder proposals requesting the board to establish such policies."), http://www.blackrock.com/corporate/en-it/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

[14] *See* Glass Lewis & Co, Proxy Paper Guidelines, 2015 Proxy Season, United States 30 (In connection with its proxy voting guidelines on the advisory vote on executive compensation Glass Lewis & Co. states: "We believe companies should adopt strict policies to prohibit executives from hedging the economic risk associated with their shareownership in the company."), http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf; *see also* Dudley W. Murrey & Jeff C. Dodd, *SEC Proposes Dodd-Frank Disclosure Rule Regarding Hedging Policies*, Andrews Kurth LLP 4 (Feb. 17, 2015) ("shareholders may well consider the Item 407(i) disclosure when determining how to vote on a say-on-pay proposal"), http://www.andrewskurth.com/pressroom-publications-1190.html.

[15] *See, e.g.,* ISS, United States, Proxy Voting Guideline Updates, 2015 Benchmark Policy Recommendations 3 (Nov. 6, 2014) (indicating that it may be appropriate under extraordinary circumstances to vote against or withhold voting for directors due to failures of risk oversight, including hedging of company stock), http://www.issgovernance.com/file/policy/2015USPolicyUpdates.pdf.

[16] *See* 80 Fed. Reg. at 8501 ("the proposed amendments could also benefit investors if the public nature of the required disclosures results in changes in hedging policies that improve incentive alignment between shareholders and executive officers or directors); *see also* Stephen H. Harris & J. Mark Poerio at 1 (Advising that in light of the proposed disclosure rules, "[o]utright prohibitions are worth considering . . . .").

[17] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services et al. 3 (July 23, 2014) ("In light of the clear linkage between the financial crisis and the need for corporate governance reforms, we believe the Commission and the Division should prioritize their future rulemakings . . . and adopt[] rules that implement the outstanding corporate governance provisions of Dodd-Frank in a high quality and effective manner that meets investors' needs."), http://www.cii.org/files/issues_and_advocacy/correspondence/2014/07_23_14_letter_Subcommittee_Capital_Markets.pdf.

The following are the Council's responses to some of the specific issues that the SEC has requested comment on in the Proposed Rule:

Does our proposal to define the term "equity securities" as equity securities of the company or any of its parents, subsidiaries or subsidiaries of its parents that are registered under Exchange Act Section 12 appropriately capture the disclosure that shareholders would find useful? Should the Commission limit the term "equity securities" to only equity securities of the company? If so, please explain why and the costs and benefits that would result. How often are directors and employees compensated through equity securities of an affiliated company that are not registered under Section 12(b) of the Exchange Act? If the definition of equity securities includes only equity securities registered under Section 12(b) of the Exchange Act, would that affect either compensation structure or corporate structure? Do companies typically have policies addressing hedging of equity securities of their parents, subsidiaries or subsidiaries of their parents? What would be the costs and benefits of disclosing whether hedging the equity securities of these affiliates is permitted or prohibited? Would any on-going compliance efforts be different? If so, please explain why and the costs and benefits that would result.[18]

We generally agree with the Commission "that the term 'equity securities' as used in proposed Item 407(i), . . . [should] mean any equity securities . . . issued by the company, any parent of the company, any subsidiary of the company or any subsidiary of any parent of the company that are registered under Section 12 of the Exchange Act."[19] Like the Commission, we believe that if a company grants equity securities of affiliated companies to their employees or directors that are intended to achieve similar incentive alignment as grants in the company's own equity securities, shareowners should be provided the proposed disclosure so that they "know whether such persons are permitted to mitigate or avoid the risks associated with long-term ownership of these securities."[20] Shareowners should not lose the benefits of the proposed disclosure simply because of the form of the equity structure of the company.

[18] 80 Fed. Reg. at 8490.
[19] *Id.* at 8489.
[20] *Id.*

Section 14(j) is directed to "any employee" and we interpret that to mean anyone employed by the issuer. Should we limit the definition of "employee" to the subset of employees that participate in making or shaping key operating or strategic decisions that influence the company's stock price? Why or why not? If so, how would that distinction be defined for practical purposes? Alternatively, should we add an express materiality condition to the definition, as is the case under CD&A to permit each issuer to determine whether disclosure about all its employees would be material information for its investors? Why or why not?[21]

We generally agree with the Commission that the term "employee" should be interpreted to include everyone employed by an issuer, including its officers. The Council's membership approved policy and corporate governance best practices indicate that many institutional investors believe that information about whether employees are allowed to effectively avoid restrictions on long-term compensation through hedging is useful information whether or not the employees are officers of the company or meet some other criterion.[22]

While we acknowledge that information about the equity holdings of employees below the executive level may in some cases be less relevant to our members and other investors,[23] we believe that incentives created by the company's nonexecutive employee compensation policies may have implications for a company's "bottom line."[24] Moreover, as indicated, we believe the information may also assist our members and other investors in making more informed voting decisions.

Should proposed Item 407(i) disclosure also be required in Securities Act and Exchange Act registration statements? Should it be required in Exchange Act annual reports on Form 10-K? Would such information be material to investors in any of those contexts?[25]

We generally agree with the Commission that the proposed Item 407(i) disclosure should be required "to be included in proxy or consent solicitation materials and information statements with respect to the election of directors."[26]

[21] *Id.* at 8490-91 (footnote omitted).
[22] § 5.8d Hedging (In 2004 the Council's policy on hedging was expanded to include language to "strongly discourage other employees from hedging their holdings in company stock."); *see* Stephen H. Harris & J. Mark Poerio at 2 (indicating that most companies in the Russell 3000 prohibit "employees" from hedging shares.).
[23] 80 Fed. Reg. at 8499 ("In other words, for employees below the executive level who typically do not make decisions that influence stock price, information about their equity holdings may be less relevant for investors.").
[24] § 5.1 Introduction (indicating that compensation decisions are important to investors for many reasons, including that pay decisions formalize performance goals for employees which impact a company's "bottom line").
[25] 80 Fed. Reg. at 8495.
[26] *Id.* at 8491.

The Commission's conclusion is generally consistent with the basis of our hedging policy which indicates member support for disclosure of company hedging activities in the annual proxy statement to the extent those activities are not otherwise prohibited.

Should smaller reporting companies or emerging growth companies be exempted from proposed Item 407(i) or subject to a delayed implementation schedule? If so, please explain why and the benefits and costs that would result. As discussed below, a component of the disclosure costs (especially initial costs) may be fixed, which may have a greater impact on smaller reporting companies and emerging growth companies. Do the proposed disclosure requirements also impose other potential costs on smaller reporting companies or emerging companies that are different in kind or degree from those imposed on other companies?). Would the proposed disclosure requirements be as meaningful for investors in smaller reporting companies and emerging growth companies as for those in other companies? Do investors in smaller reporting companies and emerging growth companies place more, less, or the same value on corporate governance disclosures of the type proposed here than do investors in larger, more established companies, either alone or in relation to other disclosures?[27]

We, like the Commission, "are not aware of any reason why information about whether a company has policies affecting the alignment of shareholder interests with those of employees and directors would be less relevant to shareholders of an emerging growth company or a smaller reporting company than to shareholders of any other company."[28] In addition, we generally agree with the Commission that given its narrow focus, it is unlikely that the proposed disclosure would "impose a significant compliance burden on [those] companies."[29]

We believe that the proposed disclosure might be of greater value to investors of smaller reporting companies (SRC) and emerging growth companies (EGC) than investors of other public companies because: (1) SRCs and EGCs are currently exempt from disclosing any policies regarding hedging by named executive officers;[30] (2) SRCs and EGCs are generally subject to greater market risk than other public companies;[31] and (3) the breadth of usage of hedging transactions by those companies.[32]

[27] *Id.* at 8496.
[28] *Id.* at 8494.
[29] *Id.*
[30] *Id.* at 8498 ("SRCs, EGCs . . . are not required to make Item 402(b) disclosure and, consequently, are not currently required to disclose any policies regarding hedging by named executive officers.").
[31] *Id.* at 8501 ("[W]e expect the potential benefits to be higher for EGCs and SRCs . . . than for non-EGCs and non-SRCs . . . , because EGCs and SRCs potentially face greater risk of a stock price decline than non-ECGs and non-SRCs.").
[32] Stephen H. Harris & J. Mark Poerio at 2 ("The breadth of usage and dollars . . . may explain why the SEC made the Proposed Rules applicable to all companies subject to the '34 Act, including smaller reporting companies, emerging growth companies . . . .").

Finally, we note that the Council's membership approved policies have long recognized that compensation is a critical and visible aspect of a company's governance.[33] We believe pay decisions are one of the most direct ways for shareowners to assess the performance of the board.[34] And, as indicated, they have a bottom line effect, not just in terms of dollar amounts, but also by formalizing performance goals for employees, signaling the market and affecting employee morale.[35] As a result, the Council has and will continue to oppose exempting SRCs and EGCs from compensation related disclosures, like the proposed disclosure, that our members generally agree, and corporate governance best practices reflect, are useful to investors.[36]

Among companies currently subject to Item 402(b), some make no disclosure of a hedging policy for named executive officers. We believe that it may be reasonable to construe the absence of a disclosure of hedging policy to mean that the company does not prevent named executive officers from hedging. Is there evidence to the contrary? Are we correct in thinking that investors may draw the same inference?[37]

We generally believe the Commission is correct that the current absence of disclosure of a hedging policy for named executive directors at some companies may lead investors to believe that the company does not prevent named executives from hedging. Such an inference is entirely understandable, particularly since some existing company hedging policies focus on only on certain types of hedging transactions or only "discourage" hedging.[38]

[33] § 5.1 Introduction
[34] *Id.*
[35] *Id.*
[36] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission 8-9 (Aug. 9, 2012) (opposing reducing certain compensation related disclosures "for EGCs or any public company unless it is first determined that those changes benefit investors"), http://www.sec.gov/comments/jobs-title-i/reviewreg-sk/reviewreg-sk-2.pdf.
[37] 80 Fed. Reg. at 8505.
[38] *See, e.g.*, *Recent Federal Securities Regulatory and Other Developments*, Covington 4 (Mar. 27, 2015), http://www.cov.com/files/Publication/ea2771dc-49e6-4a54-9157-99e7ac7da98a/Presentation/PublicationAttachment/b292aef1-3688-456e-9697-9b52dee9be09/Recent_Federal_Securities_Regulatory_and_Other_Developments.pdf.

Would the proposed disclosure requirements be likely to cause companies to change their policies on whether hedging is permitted for employees and directors? Why and how? If so, what costs would be incurred? What effect, if any, may the proxy voting policies of institutional investors and proxy advisory firms have on a company's decision to change its policy? Have institutional investors and proxy advisory firms already established hedging policy positions that have been guiding voting decisions and vote recommendations? Have institutional investors and proxy advisory firm recommendations regarding such policies encouraged companies to provide transparency into hedging transactions that are permitted at the companies? How would the transparency into hedging transactions as a result of this disclosure impact investor communication with companies about such policies? What effect will this proposed disclosure requirement have on voting decisions? Would the proposed disclosure requirements be likely to cause companies to change their compensation policies for employees (including officers) or directors? Why or why not, and if so, how?[39]

As indicated, the Council has a long-standing membership approved hedging policy. Our policies, including the hedging policy, are generally viewed as corporate governance best practices and frequently serve as a basis for the development of proxy voting guidelines by our members, other institutional investors, and the proxy advisory firms.

We believe the improved transparency into hedging transactions that would result from the Proposed Rule would likely increase the amount of investor communication with companies that permit hedging by employees and directors. That communication is likely in some cases to include encouragement to adopt the Council's hedging policy.[40]

Finally, as also indicated, we believe that the proposed disclosure may be considered by some of our members and other investors in connection with the determination of how to vote on proposals prohibiting hedging, the advisory vote on executive compensation, and in connection with the election of directors.

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[39] 80 Fed. Reg. at 8505.
[40] Council of Institutional Investors, Policies on Other Issues, Value of Corporate Governance ("Shareowners may employ a variety of tools and tactics, including filing shareowner resolutions, litigating or running director candidates, to encourage companies to adopt good corporate governance practices."), http://www.cii.org/policies_other_issues#value_corp_gov.

We appreciate your consideration of our views on the Proposed Rule. Should you have any questions regarding this letter or require any additional information, please feel free to contact me at 202.261.7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel