Via Hand Delivery

September 20, 2016

The Honorable Scott Garrett
Chairman
Capital Markets and Government Sponsored Enterprises Subcommittee
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Carolyn B. Maloney
Ranking Member
Capital Markets and Government Sponsored Enterprises Subcommittee
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Subcommittee Hearing on Corporate Governance: Fostering a System that Promotes Capital Formation and Maximizes Shareholder Value

Dear Mr. Chairman and Ranking Member Maloney:

I am writing on behalf of the Council of Institutional Investors (CII), a nonpartisan, 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 workers and their families. Our associate members include a range of asset managers with more than $20 trillion in assets under management.[1]

The purpose of this letter is to thank you for holding a hearing on corporate governance issues and to share with you a summary of our views on several matters that we understand may be raised at your hearing. In that regard, we would respectfully request that this letter be included in the hearing record.

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

Rules Governing Shareholder Proposals

CII and its members have a deep interest in ensuring that Rule 14a-8,[2] the federal rule that governs shareholder proposals, is fair and workable for shareowners and companies.[3] The rule provides an orderly means to mediate differences between managers and owners, and we are mindful that many positive advances in U.S. corporate governance practices simply would not have occurred without a robust shareowner proposal process in place.

Our members are generally comfortable with Rule 14a-8, including the threshold for filing a shareholder proposal and the 13 substantive bases for excluding shareholder proposals. Our members also appreciate the professionalism and dedication of the U.S. Securities and Exchange Commission (SEC) staff in handling the related no-action process.

While there is debate from time to time about the scope of the 13 exclusions in Rule 14a-8,[4] there is little debate among our members about the wisdom of the overall regulatory model that notifies shareowners about matters that will come before the meeting and provides companies regulatory relief from including proposals that violate state law or satisfy one of the other general categories of exclusions. We note that the existing rule and related process have the benefit of: (1) being generally well understood by both companies and proponents; (2) providing SEC staff appropriate discretion; and (3) ensuring a unified set of standards for all public companies.

Disclosure Effectiveness Initiative

CII supports SEC Chair Mary Jo White's goal for the commission's "Disclosure Effectiveness Initiative"—namely to "make disclosure more meaningful, accessible, and efficient for

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[2] 17 CFR 240.14a-8 - Shareholder proposals, Cornell U. L. School, LII, *available at* https://www.law.cornell.edu/cfr/text/17/240.14a-8 (last viewed Aug. 18, 2016).

[3] *See, e.g.,* Examining the U.S. Proxy Voting System: Is it Working for Everyone, Corporate Governance Roundtable, Hosted by Rep. Scott Garrett, 114th Cong (Nov. 16, 2015) (Statement of Amy Borrus, Interim Executive Director, Council of Institutional Investors), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/11_16_15_cii_Rep%20_Garrett_roundtable_submission_amy_borrus.pdf.

[4] *See, e,g.,* Letter from Ann Yerger, Executive Director, Council of Institutional Investors, to Keith F. Higgins, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission 1 (Jan. 9, 2015) (requesting "the Division's Staff alter its interpretation of the 'counterproposals' basis for exclusion in the Commission's Rule 14a-8"), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/01_09_15_CII_to_SEC_re_Whole_foods.pdf.

investors."[5] We believe that investors and other stakeholders benefit when regulations "ensure that important information is promptly and transparently provided to the marketplace."[6]

We agree with the SEC's Investor Advisory Committee (IAC) that "the current degree, quality and frequency of disclosure for U.S. issuers overall is appropriate and a source of strength for the U.S. capital markets."[7] We also share the IAC's view that simply reducing the volume of disclosure should not be the commission's goal;[8] we note that 80 percent of respondents to a 2012 survey of investors by the CFA Institute saw reduction of financial statement disclosure volume as unimportant.[9] It would therefore be inappropriate to prioritize volume reduction and forego the opportunity to adopt new or enhanced disclosures necessary to give investors a full picture of companies' businesses. CII encourages the commission and the subcommittee to focus primarily on protecting investors—the owners of public companies—when considering appeals for reduced or scaled disclosure under the mantra of disclosure effectiveness.

Finally, we note that six years after Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or act), final rules remain unfinished for more than two dozen of the SEC's 94 rulemaking requirements under the act.[10] In light of the commission's limited resources, we respectfully have urged the SEC to prioritize the implementation of Dodd-Frank before non-mandatory rulemaking related to disclosure and we urge the subcommittee to support that effort.[11]

Dodd-Frank Regulations

Rulemakings to implement Dodd-Frank corporate governance reforms that we believe should be given a high priority considering their relative importance to investors, include outstanding proposals on pay versus performance, clawbacks, hedging, and compensation structure.

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[5] Chair Mary Jo White, Statement at Open Meeting on Regulation SBSR, the Disclosure of Order Handling Information, and Disclosure and Simplification 5 (July 13, 2016), *available at* https://www.sec.gov/news/statement/white-statement-open-meeting-071316.html; s*ee, e.g.*, Letter from Kenneth A. Bertsch, Executive Director, Council of Investors, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 1-2 (July 8, 2016), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/07_08_16%20CII%20S-K.pdf.
[6] CII Policies, Policies on Other Issues, Value of Corporate Governance, *available at* http://www.cii.org/policies_other_issues#value_corp_gov.
[7] Letter from SEC Investor Advisory Committee, to Division of Corporate Finance, U.S. Securities and Exchange Commission 1 (June 15, 2016), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-approved-letter-reg-sk-comment-letter-062016.pdf.
[8] *Id.*
[9] CFA Institute, Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume 8 (2013) ("Eighty percent of survey respondents either do not have an issue with the length of current disclosures or think that, although current disclosures may be lengthy, they contain necessary information."), *available at* https://www.cfainstitute.org/ethics/Documents/investor-perspectives-on-disclosures.pdf.
[10] *See* Davis Polk, Dodd-Frank Progress Report 4 (July 19, 2016), *available at* https://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/.
[11] Letter from Kenneth A. Bertsch at 2.

Pay Versus Performance

CII supports the SEC's issuance of a final rule in response to Section 953(a) of the act entitled, "Disclosure of Pay Versus Performance." The SEC's proposed rule to implement Section 953(a)[12] is generally consistent with CII's membership-approved corporate governance policies, and would improve comparability of disclosure on pay and performance.[13] Those policies state:

> The Council believes that executive compensation is a critical and visible aspect of a company's governance. Pay decisions are one of the most direct ways for shareowners to assess the performance of the board. And 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.
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> The Council endorses reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the long-term, consistent with a company's investment horizon. "Long-term" is generally considered to be five or more years for mature companies and at least three years for other companies.[14]
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> The compensation committee should establish performance measures for executive compensation that are agreed to ahead of time and publicly disclosed.[15]
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> The compensation committee should commit to provide full descriptions of the qualitative and quantitative performance measures and benchmarks used to determine compensation, including the weightings and rationale for each measure. At the beginning of a period, the compensation committee should calculate and disclose the maximum compensation payable if all performance-related targets are met. At the end of the performance cycle, the compensation committee should disclose actual targets and details on final payouts. Companies should provide forward-looking disclosure of performance targets whenever possible.[16]

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[12] Pay Versus Performance, 80 Fed. Reg. 26,330 (proposed rule May 7, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-05-07/pdf/2015-10429.pdf.
[13] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent J, Fields, Secretary, Securities and Exchange Commission 3 (June 25, 2015) ("Consistent with our policies, CII generally supports the Proposal."), *available at* https://www.sec.gov/comments/s7-07-15/s70715-21.pdf.
[14] CII, Corporate Governance Policies, § 5.1 Introduction (updated Apr. 1, 2015), *available at* http://www.cii.org/files/committees/policies/2015/04_01_15_corp_gov_policies.pdf.
[15] § 5.5d Pay for Performance.
[16] § 5.5h Disclosure Practices.

Consistent with our policies, we believe the final SEC rule should require better disclosure about quantitative measures used to design and determine executive incentive pay.[17] As we explained in our comment letter to the SEC:

> [T]he legislative history of Section 953(a) references the testimony of CII's Executive Director before the Subcommittee on Securities. The key message in that testimony, which we believe was an impetus for the pay-for-performance requirement in Dodd-Frank, was the need for more and better disclosure about quantitative measures used to design and determine executive incentive pay. The continued absence of disclosure of this information, more than five years after the testimony was delivered, remains a major impediment to investor's and the market's ability to analyze and understand the compensation programs awarded to PEOs and NEOs. Consistent with our membership-approved policies, we believe requiring such quantitative information to be disclosed may be the single most important improvement the Commission could make to the Proposal.[18]

Clawbacks

CII supports the SEC's issuance of a final rule in response to Section 954 of the act entitled, "Recovery of Erroneously Awarded Compensation." The SEC's proposed rule to implement Section 954[19] is generally consistent with CII's membership approved corporate governance policies. Those policies state:

> The compensation committee should ensure that sufficient and appropriate mechanisms and policies (for example, bonus banks and clawback policies) are in place to recover erroneous bonus and incentive awards paid in cash, stock or any other form of remuneration to current or former executive officers, and to prevent such awards from being paid out in the first instance. Awards can be erroneous due to acts or omissions resulting in fraud, financial results that require restatement or some other cause that the committee believes warrants withholding or recovering incentive pay. Incentive-based compensation should be subject to recovery for a period of time of at least three years following discovery of the fraud or cause forming the basis for the recovery. The mechanisms and policies should be publicly disclosed.[20]

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[17] Letter from Jeff Mahoney at 7.
[18] *Id.* (footnote omitted).
[19] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (proposed July 14, 2015), *available at* https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.
[20] § 5.5 Pay for Performance.

Consistent with our policies, we believe the final SEC rule should, as proposed,[21] apply broadly to the compensation of all current or former executive officers whether or not they had control or authority over the company's financial reporting.[22] As we explained in our comment letter to the SEC:

> In our view, establishment of a broad clawback arrangement is an essential element of a meaningful pay for performance philosophy. If executive officers are to be rewarded for "hitting their numbers"—and it turns out they failed to do so—the unearned compensation should generally be recovered notwithstanding the cause of the revision.[23]

Finally, we note that our support for a broad clawback policy appears to be consistent with the "Commonsense Principles of Corporate Governance" recently endorsed by a number of prominent leaders of U.S. public companies, including Mary Barra, General Motors Company; Jamie Dimon, JPMorgan Chase; Jeff Immelt, GE; and Lowell McAdam, Verizon.[24] Those principles state that "companies should maintain clawback policies for both cash and equity compensation" of management.[25]

Hedging

CII supports the SEC's issuance of a final rule in response to Section 955 of the act entitled, "Disclosure Regarding Employee and Director Hedging." The SEC's proposed rule to implement Section 955[26] has important implications for the Council's long-standing membership approved corporate governance policies on hedging of compensation.[27] Those policies state:

> Compensation committees should prohibit executives and directors hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity based awards granted as long-term incentive compensation or

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[21] *See* 80 Fed. Reg. at 41,153 ("the compensation recovery provisions of Section 10D apply without regard to an executive officer's responsibility for preparing the issuer's financial statements").
[22] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 5 (Aug. 27, 2015), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/08_27_15_letter_to_SEC_clawbacks.pdf; *Contra* Financial CHOICE Act of 2016, H.R. 5983, 114th Cong., § 447 (Sept. 9, 2016) (would limit clawbacks of compensation to the current or former executive officers of a public company who had control or authority over the company's financial reporting), *available at* https://www.congress.gov/bill/114th-congress/house-bill/5983/text?resultIndex=9.
[23] Letter from Jeff Mahoney at 5 (footnotes omitted).
[24] Commonsense Corporate Governance Principles (July 2016), *available at* http://www.governanceprinciples.org/. We note that JPMorgan Chase and GE are associate members of CII.
[25] Commonsense Principles of Corporate Governance VII(g) (July 2016), *available at* http://www.governanceprinciples.org/wp-content/uploads/2016/07/GovernancePrinciples_Principles.pdf.
[26] Disclosure of Hedging by Employees, Officers, and Directors, 80 Fed. Reg. 8486 (proposed rule Feb. 17, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-02-17/pdf/2015-02948.pdf.
[27] § 5.8d Hedging.

> other stock holdings in the company. And they should strongly discourage other employees from hedging their holdings in company stock.[28]

For those companies that have not yet fully adopted our policy, we believe that a final SEC rule, as proposed, 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 allowed. Armed with the proposed disclosure, our members and other investors would be in a better position to make more informed investment and voting decisions, including voting decisions on proposals to adopt hedging policies, advisory votes on executive compensation, and voting decisions in connection with the election of directors.

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."[29] Moreover, 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."[30]

Finally, we believe the proposed disclosure also 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. For all the above reasons, the CII generally supports the issuance of a final rule as proposed.[31]

Compensation Structure

CII supports the issuance of a final rule by federal financial regulators in response to Section 956 of the act entitled, "Enhanced Compensation Structure Reporting." As we stated in our comment letter in response to the federal financial regulators proposed rule to implement Section 956,[32] the proposal is "largely consistent with CII's member-approved policies on executive compensation."[33] As indicated, those policies support reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the

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[28] *Id.*
[29] 80 Fed. Reg. at 8494.
[30] *Id.*
[31] Letter from Jeff Mahoney, General Counsel, to Brent Fields, Secretary, U.S. Securities and Exchange Commission 3 (Apr. 16, 2015), *available at* https://www.sec.gov/comments/s7-01-15/s70115-5.pdf; *Contra* Financial CHOICE Act of 2016, § 449(25) (would repeal the reporting requirements of public companies regarding employee or board member hedging of equity securities granted as compensation).
[32] Incentive-Based Compensation Arrangements, 81 Fed. Reg. 112 (proposed rule June 10, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-06-10/pdf/2016-11788.pdf.
[33] Letter from Glenn Davis, Director of Research, Council of Institutional Investors, to Patrick T. Tierney, Assistant Director, Department of Treasury, Office of the Comptroller of the Currency, Legislative and Regulatory Activities Division et al. 2 (July 15, 2016), *available at* http://www.federalreserve.gov/SECRS/2016/July/20160721/R-1536/R-1536_071516_130346_394428687994_1.pdf.

long-term, consistent with a company's investment horizon.[34] In light of those policies and the experience of the financial crisis,[35] our comment letter concludes:

> [We support] the proposed rule's over-arching requirements that incentive-based compensation arrangements at covered financial institutions 1) appropriately balance risk and reward, and 2) bar arrangements that could encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. We also support the proposed rule's recognition of the board's important role to oversee incentive-based compensation programs.[36]

We believe the issuance of a final rule, as proposed, appropriately preserves a role for incentive-based compensation at financial institutions and places a greater emphasis on risk management and long-term outcomes. The result should be greater stability for the overall market.

Other Corporate Governance Matters

Other corporate governance matters that are of importance to CII and that we understand may be raised at the subcommittee hearing include: proposed legislation relating to say-on-pay, proxy access, chairman & CEO structures, internal controls, proxy advisory firms, SEC rulemaking, and universal proxies. The first six of those items was addressed in a letter that we submitted to the Chairman and Ranking Member of the Committee on Financial Services last week in connection with the committee mark-up of H.R. 5983.[37] Those comments included the following:

Say-on-Pay

> CII opposes Section 443 the act that would amend Section 951, Shareholder Vote on Executive Compensation Disclosures, of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Section 443 would in effect reduce the frequency of say-on-pay votes. The requirements of Section 951, as implemented by the U.S. Securities and Exchange Commission (SEC), are generally consistent with CII's membership-approved corporate governance policies. Those policies state:

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[34] § 5.1 Introduction.
[35] Investors Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 22 (July 2009) (concluding that the global financial crisis resulted, in part, from "too many boards approv[ing] executive compensation plans that rewarded excessive risk-taking"), *available at* http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.
[36] Letter from Glenn Davis at 3; *Contra* Financial CHOICE Act of 2016, § 449(26) (would repeal federal financial regulator's ability to prohibit types and features of incentive-based compensation arrangements).
[37] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Jeb Hensarling, Chairman, Committee on Financial Services et al. 1-12 (Sept. 12, 2016), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/09_12_16_CII_Letter%20to%20Chair%20and%20Ranking%20Member%20of%20Committee%20on%20Financial%20Services%20(final).pdf.

> All companies should provide annually for advisory shareowner votes on the compensation of senior executives.

While Section 951(a) of Dodd-Frank, as implemented by the SEC, provides for say-on-pay votes to be held either annually, biennially, or triennially, to-date 80 percent of public companies have opted for annual votes consistent with our policy. An annual say-on-pay vote is critical to investors, in part, because it provides shareowners with the ability to communicate their views on the most recent payouts stemming from the policies used to administer executive compensation practices. Those payouts may change in unforeseeable and unexpected ways due to a policy's complexity, reliance on forward-looking factors, and accommodation of board discretion.

It is now widely recognized that an annual vote on executive compensation has resulted in a number of ongoing improvements to the process in which corporate boards determine executive pay, including:

- Boards are actively and frequently reaching out to shareowners to solicit their concerns about, and their approval of, executive compensation plans;
- Boards are increasing the proportion of executive compensation linked to company performance, leading to potentially greater alignment between the two; and
- Boards are eliminating executive compensation perks such as club memberships that they are unable to rationalize.[38]

Proxy Access

CII opposes Section 449(30) of the act that would repeal Section 971, Proxy Access, of Dodd-Frank. We believe that proxy access—a mechanism that enables shareowners to place their nominees for director on a company's proxy card—is a fundamental right of long-term shareowners. Proxy access gives shareowners a meaningful voice in board elections.

CII's member-approved policy on proxy access states, in part:

> Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least three percent of a company's voting stock, to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years.

[38] *Id.* at 1-2 (footnotes omitted).

CII also generally supports an approach to proxy access similar to the one that the SEC adopted in 2010 but was later vacated after a court challenge. Now, more than five years later, about 240 U.S. public companies have adopted proxy access in a form generally consistent with our policy.

According to ISS Corporate Solutions, 38 percent of the S&P 500 have a proxy access process. The companies that implemented proxy access are from a variety of industries. They include Intercontinental Exchange (the parent company of the New York Stock Exchange), Apple, United Airlines, CarMax, JPMorgan Chase and Apache.

Given the clear growing trend of public companies adopting proxy access, there may come a time when both companies and shareowners favor a more uniform minimal set of standards and requirements for proxy access. If that time should arrive, Section 971 would facilitate the SEC's ability to respond and provide any needed standards and requirements.[39]

Chairman & CEO Structures

CII opposes Section 449(31) of the act that would repeal Section 972, Disclosures Regarding Chairman and CEO Structures, of Dodd-Frank. We note that the SEC adopted rules in December 2009 that, in effect, implemented the disclosure requirements of Section 972. Those rules were generally consistent with CII's membership approved policies. Those policies state:

> The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who should have approval over information flow to the board, meeting agendas and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

Now, more than six years later, we continue to strongly support the SEC's required leadership structure disclosures, particularly in light of the growing body of evidence indicating that splitting the chairman and CEO roles may "save money and improve company's performance."[40]

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[39] *Id.* at 5-6 (footnotes omitted).
[40] *Id.* at 6 (footnotes omitted).

Internal Controls

CII opposes Section 445 of the act that would further expand the existing exemptions for public companies for having an external, independent auditor attest to, and report on, management's assessment of internal controls over financial reporting as generally required by Section 404(b) of the Sarbanes-Oxley Act. As explained in a comment letter from CII and the Center for Audit Quality in response to a recent SEC proposal:

> We believe that any amendment that erodes Section 404(b) would substantially impact the quality of financial reporting by public companies to the detriment of investors and our capital markets more generally. . . . . We believe Section 404(b) continues to be significant as it provides investors with reasonable assurance from the independent auditor that a company maintained effective internal control over financial reporting. This assurance is an important driver of confidence in the integrity of financial statements and in the fairness of our capital markets. A Government Accountability Office report found that companies exempted from Section 404(b) experience more financial restatements, as compared to nonexempt companies; and the percentage of exempt companies restating has generally exceeded that of nonexempt companies. According to this report, companies that obtained an auditor attestation generally had fewer financial restatements than those that did not.
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> Complying with Section 404(b) has a benefit for issuers. Academic research has demonstrated that the cost of capital for companies that voluntarily comply with Section 404(b) is lower than peer companies and has decreased for public companies since enactment of the Sarbanes-Oxley Act, especially for smaller companies.
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> Lastly, while the cost of compliance with Section 404(b) is often cited as a concern by issuers, an SEC study concluded that such costs have declined by approximately 30 percent after the PCAOB adopted Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements,* and the SEC issued management guidance on Section 404(a) in 2007.[41]

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[41] *Id*. at 6-7 (footnotes omitted).

Proxy Advisory Firms

CII opposes Sections 1081 to 1083 of the act that would unduly restrict the ability of proxy advisory firms to provide voting information to institutional investors who voluntary contract for such information. Proxy advisory firms play a vital and necessary role in assisting many pension funds and other institutional investors in carrying out their fiduciary duty to vote proxies. By law, pension fund fiduciaries have a duty to ensure that their proxies are voted in the best long-term interests of plan participants and beneficiaries. Many pension funds and other institutional investors contract with proxy advisory firms to obtain and review their research. But most large holders vote according to their own guidelines and policies.

As you may be aware, just last week we provided you with a copy of a letter co-signed by 30 CII members and other organizations expressing concerns about the proxy advisory firm provisions incorporated into the act. Those provisions and our specific related concerns include the following:

> **Require that proxy advisory firms (1) provide companies advance copies of their recommendations and most elements of the research informing their reports, (2) give companies an opportunity to review and lobby the firms to change their recommendations, and (3) establish a heavy-handed "ombudsman" construct to address issues that companies raise.**
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> This right of pre-review would give companies substantial influence over proxy advisory firms' reports, potentially undermining the objectivity of the firms' recommendations. On a practical level, this right of review would delay pension funds and other institutional investors' receipt of the reports and recommendations for which they have paid.
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> The requirement that the proxy advisory firms resolve company complaints prior to the voting on the matter would create an incentive for companies subject to criticism to delay publication of reports as long as possible. Pension funds and other institutional investors would have less time to analyze the reports and recommendations in the context of their own customized proxy voting guidelines to arrive at informed voting decisions. Time already is tight, particularly in the highly concentrated spring "proxy season," due to the limited period between company publication of the annual meeting proxy statement and annual meeting dates.
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> Moreover, the proposed legislation does not appear to contemplate a parallel requirement that dissidents in a proxy fight, or proponents of shareowner proposals, also receive the recommendations and

> research in advance. This would violate an underlying tenet of U.S. corporate governance that where matters are contested in corporate elections, management and dissident shareowners should operate on an even playing field.
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> **Require the Securities and Exchange Commission (SEC) to assess the adequacy of proxy advisory firms' "financial and managerial resources**."
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> The entities that are in the best position to make these types of assessments are the pension funds and other institutional investors that choose to purchase and use the proxy advisory firms' reports and recommendations. In 2014, the SEC staff issued guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents. We publicly supported that guidance. We are unaware of any compelling empirical evidence indicating that the guidance is not being followed or that the burdensome federal regulatory scheme contemplated by the proposed legislation is needed.
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> The proposed legislation would appear to result in higher costs for pension plans and other institutional investors – potentially much higher costs if investors seek to maintain current levels of scrutiny and due diligence around proxy voting. Moreover, the proposed legislation is highly likely to limit competition, by reducing the current number of proxy advisory firms in the U.S. market and imposing serious barriers to entry for potential new firms. This would also drive up costs to investors. Given these economic impacts, we are troubled that there appears to be no cost estimate on the provisions of this proposed legislation.[42]

SEC Rulemaking

CII opposes Sections 611 to 621 of the act that would replace the SEC's existing economic analysis for rulemaking. As an association of long-term shareowners interested in maximizing share values, CII believes it is vital to avoid unnecessary regulatory costs. However, it is not clear to us how the provisions of the act would improve the cost-effectiveness of the SEC's existing rulemaking process or benefit long-term investors, the capital markets or the overall economy. The SEC's

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[42] *Id.* at 8-10 (footnotes omitted).

> rulemaking process is already governed by a number of legal requirements, including those under the federal securities laws, the Administrative Procedure Act, the Paperwork Reduction Act of 1980, the Small Business Regulatory Enforcement Fairness Act of 1996 and the Regulatory Flexibility Act.
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> Moreover, under the federal securities laws, the SEC generally is required to consider whether its rulemakings are in the public interest and, in addition to the protection of investors, whether they promote efficiency, competition and capital formation. Since the 1980s, the SEC has conducted, to the extent possible, analyses of the costs and benefits of its proposed rules.
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> The SEC has further enhanced the economic analysis of its rulemaking process in recent years. That process is, and has long been, far more extensive than that of any other federal financial regulator.
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> We believe the act's provisions would pose substantial risk to the SEC's regulatory capacity and to the capital markets. The provisions are based on a faulty premise that a generally accepted methodology currently exists that allows the SEC in a cost-effective manner to reliably measure, and then balance, all of the costs and benefits of its proposals consistent with its mandate to protect investors. We note it is well established that while some of the costs of some financial regulatory proposals can be reliably estimated, the same is generally not true for the benefits.
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> In most instances, the benefits as well as many of the costs of an SEC rule designed to protect investors, cannot be reliably measured. Thus, the act's provisions would appear to impose on the SEC a costly, one-sided, incomplete analysis in which the commission would likely never be able to conclude that the quantified benefits of a proposal outweigh the quantified costs. As a result, the Act's provisions would unnecessarily constrain the ability of the SEC to issue any substantive proposals in furtherance of its mission to protect investors—the element of its mission that, in our view, is most critical to maintaining and enhancing a fair and efficient capital market system.[43]

Universal Proxies

Finally, CII opposes proposed legislation that would bar the SEC from issuing a proposed rule for public comment on universal proxies.[44] As background, on January 8, 2014, CII filed a detailed rulemaking petition with the SEC to amend Section 14 of the Securities Exchange Act

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[43] *Id.* at 10-12 (footnotes omitted).
[44] *See, e.g.,* Christopher Hosford, House Blocks SEC's Universal Proxy Ballot Plan, CFO.com, July 8, 2016, at (reporting that "the House voted 243-180 . . . to add language to a spending bill for the fiscal year that would bar the SEC from writing a universal ballot rule), *available at* http://ww2.cfo.com/governance/2016/07/house-blocks-secs-universal-proxy-ballot-plan/.

of 1934 to facilitate the use of universal proxies in contested elections of directors ("petition").[45] The petition was derived from our membership approved policies for director elections which states:

> To facilitate the shareholder voting franchise, the opposing sides engaged in a contested election should utilize a proxy card naming all management-nominees and all shareholder-proponent nominees, providing every nominee equal prominence on the proxy card.[46]

The problem that universal proxies would resolve is a problem that was clearly articulated by the SEC's IAC in 2013: Namely, investors are currently disenfranchised in a proxy contest, to the extent they vote by proxy, because they have no practical ability to "split their ticket" and vote for the combination of shareowner nominees and management nominees that they believe best serve their economic interests.[47]

We are unaware of any empirical evidence indicating that universal proxies would favor shareowner-proponent board nominees over company-nominees (or the reverse).[48] If such evidence does exist, it could be provided to the SEC by commentators for consideration as part of the commission's public rulemaking process.

The more relevant question for the SEC and the subcommittee is whether universal proxies would provide investors with the ability to more fully exercise their fundamental right to vote for the election of public company directors in a proxy contest. The answer to that question is unequivocally yes.

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[45] Letter from Glenn Davis, Director of Research, Council of Institutional Investors, to Ms. Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission (Jan. 8, 2014), *available at* https://www.sec.gov/rules/petitions/2014/petn4-672.pdf.
[46] § 2.2 Director Elections.
[47] Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots 2 (adopted July 25, 2013), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf.
[48] *See, e.g.,* Tatyana Shumsky, SEC Weighs Universal Proxy Vote Cards, Wall St. J., Feb. 19, 2016, at 1 (Quoting Michelle Anderson, associate director in the SEC's Division of Corporation Finance, that the universal proxy project is "'not about favoring the company of the dissident'"), *available at* http://blogs.wsj.com/cfo/2016/02/19/sec-weighs-universal-proxy-vote-cards/.

Thank you for considering these views. We would be very happy to discuss our perspective on these issues with you or your staff at your convenience. I am available at jeff@cii.org or by telephone at (202) 822-0800.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel