Via Hand Delivery

November 10, 2016

The Honorable Mitch McConnell
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Harry Reid
Minority Leader
United States Senate
Washington, DC 20510

The Honorable Paul D. Ryan
Speaker
United States House of Representatives
Washington, DC 20515

Nancy Pelosi
Minority Leader
United States House of Representatives
Washington, DC 20515

Dear Messrs. Majority Leader, Speaker and Minority Leader and Madam Minority Leader:

As the United States Congress considers funding bills in the upcoming lame duck session, we respectfully urge you to remove any policy riders that are inconsistent with good corporate governance.

The Council of Institutional Investors (CII) is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our voting member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate (non-voting) members include a range of asset managers with more than $20 trillion in assets under management.[1]

CII has long held that good corporate governance—defined to include general issues affecting market transparency, integrity and accountability and specific relationships between boards, management and shareowners—is in the best long-term interests of shareowners and the U.S. capital markets.[2] We believe that shareowners, other investors and stakeholders benefit when cost-effective rules and regulations provide adequate protections to owners and ensure that important information is promptly and transparently provided to the marketplace.[3]

[1] For more information about the Council of Institutional Investor (Council or CII) and our members, please visit the Council's website at http://www.cii.org/members.
[2] CII, Policies on Other Issues, Value of Corporate Governance, *available at* http://www.cii.org/policies_other_issues#value_corp_gov.
[3] *Id.*

Potential policy riders that are inconsistent with good corporate governance that we would strongly oppose include the following:

1. A policy rider that would bar the Securities and Exchange Commission (SEC) from issuing a final rule on universal proxies[4]

   Just in October, the SEC issued for public comment a proposal that would require proxy contestants for corporate board seats to provide shareowners with a universal proxy card that includes the names of both management and dissident director nominees.[5] The proposal is important to good corporate governance because it removes a long-standing flaw in the U.S. proxy system. That flaw effectively disenfranchises shareowners who vote by proxy cards—the vast majority of shareowners—instead of voting in person. Currently, shareowners, have no practical ability through proxy voting to "split their ticket" and vote for the combination of shareowner and management nominees that they believe best serve their economic interests.[6]

   The SEC's proposal also is consistent with CII's corporate governance best practices for director elections that 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.[7]

   While proxy contests are rare events, the right of shareowners to elect directors to represent them is a fundamental right of share ownership. That right is especially critical when there is a proxy contest. Contested elections are pivotal events for companies and for shareowners, since board seats, and in some cases, board control, are at stake. The dissident group usually advances a specific strategic, operational or financial agenda, so it is important for shareowners to be able to participate fully, regardless of how they vote.

   Importantly, requiring universal proxies would benefit retail investors and institutional investors with relatively smaller positions by allowing them to choose among all board nominees without attending the shareholder meeting, which can involve travel and other

---

[4] In July 2016 the U.S. House of Representatives voted 243-180 to add language to a spending bill that would have barred the SEC from writing a rule on universal proxies. Financial Services and General Government Appropriations Act, 2017 (Version Placed on Senate Calendar Jul. 12, 2016) H.R. 5485, 114th Cong. (2015-2016) § 1215 (2016) ("None of the funds made available by this Act may be used by the Securities and Exchange Commission to propose, issue, implement, administer, or enforce any requirement that a solicitation of a proxy, consent, or authorization to vote a security of an issuer in an election of members of the board of directors of the issuer be made using a single ballot or card that lists both individuals nominated by (or on behalf of) the issuer and individuals nominated by (or on behalf of) other proponents and permits the person granting the proxy, consent, or authorization to select from among individuals in both groups."), *available at* https://www.congress.gov/bill/114th-congress/house-bill/5485/text.

[5] Press Release, SEC Proposes Amendments to Require Use of Universal Proxy Cards (Oct. 26, 2016), *available at* https://www.sec.gov/news/pressrelease/2016-225.html.

[6] Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots 2-4 (Adopted July 25, 2013), *available at* http://www.sec.gov/spotlight/investor-advisorycommittee-2012/universal-proxy-recommendation-072613.pdf.

[7] CII, Corporate Governance Policies § 2.2 Director Elections (updated Sept. 30, 2016), *available at* http://www.cii.org/files/policies/09_30_16_corp_gov_policies.pdf.

costs that may be prohibitive. Moreover, the current system of competing slates of nominees may be disproportionately confusing to retail investors, who are presented with multiple conflicting proxy cards and may not realize that tabulators count only the most recently submitted card.

In addition, empirical evidence indicates universal proxies do not favor dissidents over management.[8] On this point, a 2016 study by Harvard Law School Professor Scott Hirst of proxy contests from 2008 and 2015 found about 22 percent might have turned out differently with a universal proxy.[9] The study concludes:

> Distorted proxy contests have slightly favored dissident nominees; a universal proxy rule would have slightly favored management nominees in the same contests. However, given the two effects are relatively balanced, a universal proxy rule is unlikely to strongly favor one side over the other.[10]
>
> . . . .
>
> The significant benefits of universal proxies in eliminating distorted proxy contests would outweigh the improbable costs foreseen from universal proxies. The net effect of universal proxies would be to better enfranchise shareholders.[11]

2. <u>A policy rider that would create a new federal regulatory scheme for proxy advisory firms</u>

In approving H.R. 5311, the Corporate Governance Reform and Transparency Act of 2016, in September,[12] the House Financial Services Committee promoted legislation that, if enacted as a rider or otherwise, would diminish, rather than improve, corporate governance to the detriment of the investing public.

As indicated, the U.S. system of corporate governance relies on the accountability of boards of directors to shareowners. Proxy voting by pension funds and other institutional investors is a critical means by which long-term shareowners are able to hold boards accountable.

Proxy voting by pension funds and other long-term investors is facilitated by proxy advisory firms. Proxy advisory firms like Institutional Shareholder Services and Glass Lewis offer for a fee: data, analysis and tailored vote recommendations to help

---

[8] Scott Hirst, Harvard Law School, Universal Proxies 7 (Aug. 24, 2016), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2805136.
[9] *Id.*
[10] *Id.*
[11] *Id*. at 8.
[12] H.R. 5311, Corporate Governance Reform and Transparency Act of 2016, 114th Cong. (2015-2016), *available at* https://www.congress.gov/bill/114th-congress/house-bill/5311/actions.

institutional investors exercise their ownership rights on literally thousands of proxy issues annually.

Many pension funds and other institutional investors are concerned, that if enacted, H.R. 5311, would:[13]

- 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.

  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.

  The requirement that the proxy advisory firms resolve companies' complaints prior to 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.

  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 holds where matters are contested in corporate elections, management and dissident shareowners should operate on an even playing field.

- Require the SEC to assess the adequacy of proxy advisory firms' "financial and managerial resources."

  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

---

[13] *See, e.g.*, Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing and Urban Affairs et al. 2-3 (Sept. 6, 2016) (signed by 30 CII members and other organizations), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/September%206%20Letter%20to%20Senate%20Banking%20on%20Proxy%20Advisory%20Firms.pdf.

guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents.[14] There is no 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.

- Create costs for institutional investors with no clear benefits.

  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 drive up costs to investors. Given these economic impacts, it is troubling that that there appears to be no comprehensive estimate of costs to investors of the proposed legislation.[15]

3. A policy rider that would reduce the transparency and oversight of private equity firms

   In September, the House approved H.R. 5424, the Investment Advisors Modernization Act of 2016.[16] The proposed bill, if enacted through a rider, would roll back important transparency and reporting requirements that CII and many of our members believe are critical to investor protection.[17]

---

[14] Staff Legal Bulletin No. 20 at 3 (June 13, 2014) ("it is the staff's position that an investment adviser that receives voting recommendations from a proxy advisory firm should ascertain that the proxy advisory firm has the capacity and competency to adequately analyze proxy issues, which includes the ability to make voting recommendations based on materially accurate information"), *available at* https://www.sec.gov/interps/legal/cfslb20.htm.

[15] The Congressional Budget Office has produced a cost estimate for H.R. 5311. The cost estimate, however, was limited only to the costs of the additional U.S. Securities and Exchange Commission Staff that would be necessary to "create and maintain the registry and to prepare annual reports." CBO, H.R. 5311, Corporate Governance Reform and Transparency Act of 2016, Cost Estimate (July 12, 2016), *available at* https://www.cbo.gov/publication/51792.

[16] H.R. 5424, Investment Advisors Modernization Act of 2016, 114th Cong. (2015-2016), *available at* https://www.congress.gov/bill/114th-congress/house-bill/5424.

[17] *See* Letter from Jack Ehnes, Chief Executive Officer, California State Teachers' Retirement System, to The Honorable Jeb Hensarling, Chairman, House Committee on Financial Services et al. 2 (June 10, 2016) ("This proposed legislation would actually roll back the important investor protections provided to funds like CalSTRS from Dodd-Frank which required transparency in the form of registration and certain reporting from these fund advisers.") (on file with CII); *see also* Letter from Anne Simpson, Investment Director, Global Governance, CalPERS, to The Honorable Jeb Hensarling, Chairman, House Committee on Financial Services et al. 2 (June 10, 2016) ("We believe H.R. 5424 would erode the Dodd-Frank provisions that established greater transparency into private equity funds, . . . and enhanced the ability of regulators to effectively monitor systemic risk in the private fund industry.") (on file with CII); *see generally*, A Report by the Investors' Working Group, U.S. Financial Reform: The Investors' Perspective 15 (July 2009) (recommending "transparency and oversight" of private equity and hedge funds because of their systemic importance to the market), *available at* http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

For example, and particularly troubling to many of our members, H.R. 5424 would remove certain SEC reporting requirements for large private equity funds. In Congressional testimony, Jennifer Taub, professor of law at Vermont Law School, warned that if enacted, such a provision would:

> [P]romote opacity by allowing private equity funds to retreat into the shadows, gaining exceptions from completing [F]orm PF just a few years after they began doing so. This information is important to monitor for systemic risk and to protect investors. If enacted, private equity fund advisers could stop completely section 4 of the form. This section provides important information related to leverage and counterparty risk. It also includes information concerning geographic and industry breakdown of portfolio companies.
>
> In addition, if enacted, section 1c of Form PF would apparently no long[er] have to be completed by hedge fund advisers with between $150 million and $1.5 billion in [assets under management] AUM. The information is very important as it provides insight into trading and clearing of derivatives as well as short-term wholesale funding including bilateral and triparty repo[s]. Given that derivatives and the short-term wholesale funding markets accelerated the financial crisis and still remain a source of risk, it is critical for the SEC . . . to gather this information.[18]

****

Thank you for considering our views. If you would care to discuss any of the above issues in more detail, please feel free to contact me at 202.822.0800.

Sincerely,

Jeff Mahoney
General Counsel

[18] Legislative Proposals to Enhance Capital Formation, Transparency, and Regulatory Accountability, Hearing before the H. Subcomm. on Cap. Mkts. & Gov't Sponsored Enters. of the Comm. on Fin. Servs., 114th Cong. 10 (May 17, 2016) (written testimony of Jennifer Taub, Professor of L., Vt. L. Sch.), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-jtaub-20160517.pdf.