Via Electronic Delivery

April 29, 2017

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Mark-up of H.R. 10, the Financial CHOICE Act of 2017[1]

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.[2]

The purpose of this letter is to share with you an updated summary of our current views on H.R. 10, the Financial CHOICE Act of 2017 (Act) in connection with your scheduled mark-up of the Act on May 2.[3] As significant long-term investors, CII member funds have a deep, abiding interest in ensuring that the U.S. capital markets are on a sound footing. Americans suffered enormously from the 2001 Enron scandal and the 2008 financial crisis – they lost jobs, homes and retirement savings – and we can't go back.

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[1] Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (Apr. 26, 2017), *available at* https://www.congress.gov/bill/115th-congress/house-bill/10/text?q=%7B%22search%22%3A%5B%22financial+CHOICE+act%22%5D%7D&r=2.

[2] 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.

[3] *See, e.g.*, Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Jeb Hensarling, Chairman, Committee on Financial Services, United States House of Representatives et al. (Apr. 24, 2017), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/Apr%2024%20Letter%20Committee%20on%20Financial%20Services_FINAL.pdf.

While we do not have a position on most of the provisions contained in the Act, we must oppose the bill in its current form because it includes a number of troubling provisions that would threaten prudent safeguards for oversight of companies and markets, including sensible reforms that investors need to hold management and boards of public companies accountable, and that foster trust in the integrity of the markets. The remainder of this letter describes those provisions, and our related concerns, in the order in which they currently appear in the Act.

We would respectfully request that this letter be included in the public record for the mark-up.

<u>SEC Rulemaking</u>

CII would amend Sections 311 and 334 of the Act to remove the U.S. Securities and Exchange Commission (SEC) from the costly, time consuming, and incomplete cost-benefit analysis and the Congressional review provisions of Title III, Subtitle A and B of the Act, respectively.

As an association of long-term shareowners interested in maximizing share values, we believe 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.

As we explained in a recent letter to Speaker Ryan and Minority Leader Pelosi regarding similar cost-benefit provisions of H.R. 78:

> The Commission's 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. Moreover, under the federal securities laws, the SEC is generally required to consider whether its rulemakings are in the public interest and will protect investors and promote efficiency, competition and capital formation.
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> Since the 1980s, the Commission has conducted, to the extent possible, an analysis of the costs and benefits of its proposed rules. The SEC has further enhanced the economic analysis of its rulemaking process in recent years. *That process is far more extensive than that of any other federal financial regulator.*
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> . . . .
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> The [cost-benefit] provisions . . . would create a false and misleading expectation that the SEC can reasonably measure, combine and compare the balance of all costs and benefits of its proposals consistent with its mandate to protect investors. As explained by Professor Craig M. Lewis, former chief economist and director of the SEC's Division of Economic and Risk Analysis: "[W]ith regard to investor

> protection, the Commission is often unable to reasonably quantify the related benefits or costs."
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> [The cost-benefit provisions] . . . would impose upon the SEC a costly, time consuming and incomplete analysis in which the Commission would be hard pressed to determine that the benefits of a proposal or rule "justify the costs of the regulation."[4]

The application of the Act's Congressional review provisions to SEC rulemaking is perhaps even more troubling for long-term investors. On this issue, we generally agree with the following comments of Broc Romanek of the TheCorporateCounsel.net:

> The "Financial Choice Act" is much more than merely repealing big chunks of Dodd-Frank. There are a handful of provisions that would render the SEC's ability to conduct rulemaking much more difficult. But this provision in particular . . . just blows me away:
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> . . . A joint Congressional resolution to adopt a "major" rule – and even some non-major ones! It's goal appears to be neutering the so-called "independent" federal agencies that govern our financial institutions & markets. Talk about putting partisan politics into "independent" agencies. And here I was worried that having Congress involved in the SEC's budget process was too much meddling with a federal agency!
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> Remember that federal agencies are part of the executive branch of government. Not to mention that members of Congress don't have the expertise, resources or time to understand what the various rules of an agency are. This would be a major windfall for lobbyists who would be able to effectively pay Congress to stop an agency from doing anything. Either the Senate or the House could stop a rulemaking – by simply sitting on their hands. The polar opposite of needing an "Act of Congress" to change something. It's brazen & breathtaking – and a whole lot of other things that I can't mention in this family-oriented blog.[5]

We believe the Title III, Subpart A and B provisions, individually, and particularly when combined, 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.

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[4] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Paul D. Ryan, United States House of Representatives et al. 2-3 (Jan. 11, 2017) (emphasis added & footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/01_11_17_letter_house_leadership_HR78.pdf.

[5] Broc Romanek, Financial CHOICE Act: One Provision Could Destroy the SEC's Rulemaking, TheCorporateCounsel.net Blog (Nov. 17, 2016), *available at* https://www.thecorporatecounsel.net/blog/2016/11/financial-choice-act-one-provision-could-destroy-the-secs-rulemaking-abilities.html.

Proxy Research

CII opposes Sections 481-483 of the Act because it would establish an additional costly federal regulatory superstructure for proxy advisory firms that institutional investors, the primary customer of those firms' research services, do not want or need.

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.

Proxy research is helpful in enabling cost effective proxy voting, particularly when a fund holds thousands of companies in their investment portfolio.[6] We, and many of our members, believe the existing SEC regulatory regime already protects the interests of long-term shareowners with respect to proxy advisory firms and that the Act's new regulatory scheme is unnecessary, overly burdensome, and counter-productive.[7]

Last September a letter co-signed by 30 CII members and other organizations expressed concerns about the Act's proxy advisory firm provisions.[8] A description of those provisions and 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

[6] *See*, *e.g.*, Letter from Jack Ehnes, Chief Executive Officer, CalSTRS, to The Honorable Maxine Waters, Ranking Member, House Committee on Financial Services 2 (Apr. 25, 2017) (on file with CII).

[7] *Id.* at 3; *see* Financial CHOICE Act of 2017, Hearing Before the H. Comm. on Fin. Servs., 115th Cong. 13 (Apr. 26, 2017) (Testimony of Michael S. Barr, The Roy F. and Jean Humphrey Proffitt Professor of Law, University of Michigan Law School) ("The proposed legislation would . . . burden proxy advisory firms."), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-115-ba00-wstate-mbarr-20170426.pdf.

[8] 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, United States Senate et al. (Sept. 6, 2016), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/September%206%20Letter%20to%20Senate%20Banking%20on%20Proxy%20Advisory%20Firms.pdf; *see* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Jeb Hensarling, Chairman, House Committee on Financial Services et al. (June 13, 2016) (letter co-signed by 27 CII members and other institutional investors strongly opposing H.R. 5311), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/06_13_16_FINAL_Letter_on_Proxy_Advisory_Firm_Bill.pdf; *see also* Editorial, Undermining Proxy-Voting Advice, Pensions & Invs., June 27, 2016, at 1 ("A bill pending in Congress would undermine proxy-voting firms and consequently weaken the capability of asset owners and other institutional investors to bring to bear their crucial resources to assist in voting on proxy issues at publicly traded companies") (registration required), *available at* http://www.pionline.com/article/20160627/PRINT/306279998/undermining-proxy-voting-advice.

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 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.

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.

Require the Securities and Exchange Commission (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 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.

. . . .

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.[9]

Our current views on Sections 481-483 of the Act are consistent with those of former SEC Director of Corporation Finance Keith F. Higgins who recently commented:

> Under this regime, proxy advisory firms would be required to register with the Commission, allow companies to review their reports before issuance, disclose potential conflicts of interest and provide financial reports. Although I don't dismiss concerns about the influence of proxy advisory firms, *I don't think the proposed regulatory regime is the answer*. Part of the problem in the industry is a lack of competition. For example, various sources report that the two largest players, ISS and Glass Lewis, control approximately 97% of the proxy advisory services market. It is unclear how added regulatory burdens will help promote competition. Typically, imposing additional regulation is a costly impediment to new entrants, and in turn, may bolster the incumbents' market position.
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> *It is interesting that the clients who use proxy advisory reports don't seem to be complaining*. In fact, they often favor the ease, readability, and comparability of the reports.
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> *I don't think placing an additional regulatory support superstructure on proxy advisory firms is the solution*.[10]

Public Company Accounting Oversight Board (PCAOB)

CII opposes Section 833 of the Act because it would abolish the Investor Advisory Group to the independent, private sector PCAOB.

The PCAOB's mission, as mandated by Congress, is to protect investors.[11] Investors are the primary users of the audited financial reports that the PCAOB oversees. Therefore, we believe, consistent with our membership approved policies that the primary role of the PCAOB should be

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[9] 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, United States Senate et al. at 8-10 (footnotes & emphasis omitted).
[10] Keith F. Higgins, Keynote Address at the Practicing Law Institute Corporate Governance – A Master Class 2-3 (Mar. 9, 2017) (emphasis added) (on file with CII).
[11] *See* PCAOB, Our Mission ("the Public Company Accounting Oversight Board oversees the audits of public companies in order to protect the interests of investors"), *available at* https://pcaobus.org/Careers/Pages/our-mission.aspx.

to ensure that investors' information needs are met.[12] To do this, the board and its staff must actively solicit and carefully consider investor input.[13] We believe the PCAOB's Investor Advisory Group, on which our former Executive Director served, is an important entity in this process, charged with obtaining investors' views and advice on matters that the board must consider when fulfilling its mission to protect investors.[14]

It is unclear to us why some in Congress would want to abolish an investor advisory group to an independent, private sector organization whose mission is to protect investors.

Say-on-Pay

CII opposes Section 843 of the Act because it would likely reduce the required frequency of shareholder advisory votes on executive compensation, commonly called say-on-pay votes.

The requirements of Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) entitled, "Shareholder Vote on Executive Compensation Disclosures," as implemented by the SEC, are generally consistent with CII's membership-approved corporate governance policies.[15] Those policies state:

> All companies should provide annually for advisory shareowner votes on the compensation of senior executives.[16]

While the existing requirement provides for say-on-pay votes to be held annually, biennially, or triennially, to date over 90% of public companies have opted for annual votes consistent with our policy.[17] Voting trends, investor preferences and results from our member survey indicate that support for annual say-on-pay in 2017 will be at or above that level.[18]

Section 843 of the Act would change the frequency of advisory shareowner votes on executive compensation from at least one every three years to only when there is a "material change" in compensation of executives of an issuer from the previous year. The Section is ambiguous as to

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[12] *See* CII Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017) (the primary role . . . should be to satisfy in a timely manner investors' information needs), *available at* http://www.cii.org/policies_other_issues#indep_acct_audit_standards.

[13] *Id.* (indicating the Public Company Accounting Oversight Board should have a "thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views").

[14] *See, e.g.*, Steve Burkholder, GOP Bill Would Abolish Audit Overseer's Investor Adviser Panel, Bloomberg BNA, Apr. 26, 2017, at 1 ("investor advocates and proponents of strong auditing aren't happy with the draft Financial CHOICE Act's planned demise of the relatively obscure panel [because] . . . [t]hey say its advisory work contributes directly to the PCAOB's mission—to protect investors"), *available at* https://www.bna.com/gop-bill-abolish-n57982087331/

[15] CII Policies, §5.2 Advisory Shareowner Votes on Executive Pay (updated Sept. 30, 2016), *available at* http://www.cii.org/corp_gov_policies.

[16] *Id.*

[17] CII, Say-On-Pay Frequency: A Fresh Look 1 (Dec. 2016), *available at* http://www.cii.org/files/publications/misc/12_22_16_SOP_Frequency_Report_Formatted.pdf

[18] *Id.*

what is a material change and whether a material change would need to be for only one executive or for all executives as a group. In any event, the provision appears to be designed to "limit shareholder's ability to vote annually on 'say on pay' management compensation."[19]
We believe 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 board discretion.

In addition, it is 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 blur the line between personal and business expenses.[20]

Shareholder Proposals

CII opposes Section 844 of the Act because it would dramatically restrict the ability of shareowners to file proposals on important governance issues.

CII and its members have a deep interest in ensuring that Rule 14a-8, the federal rule that governs shareholder proposals, [21] is a fair and workable standard for shareowners and companies.[22] The current rule provides an orderly means to mediate differences between managers and owners. It is not broken, and, therefore, does not need to be fixed.

We are also mindful that many positive advances in U.S. corporate governance practices simply would not have occurred without a robust shareowner proposal process in place. For example:

- Shareholder proposals were the impetus behind the now standard practice—currently mandated by major U.S. stock exchanges' listing standards—that independent directors constitute at least a majority of the board, and that all the

[19] Testimony of Michael S. Barr at 13.
[20] *See, e.g.,* Paul Hodgson, Surprise Surprise: Say on Pay Appears to Be Working, Fortune.com, July 8, 2015, at 1-2, *available at* http://fortune.com/2015/07/08/say-on-pay-ceos/.
[21] 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 Apr. 23, 2017).
[22] *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. 7 (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.

members of the following board committees are independent: audit, compensation, nominating and corporate governance.

- In 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, less than 40 percent of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.
- Electing directors in uncontested elections by majority (rather than plurality) vote was considered a radical idea a decade ago when shareholders pressed for it in proposals they filed with numerous companies. Today, 90 percent of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority voting proposals.
- A proposal that built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years is the request for proxy access. Resolutions filed by the New York City Comptroller to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, at least 400 companies have adopted proxy access bylaws.[23]

Section 844 of the Act would radically increase the regulatory hurdles for shareholder proposals. Current rules set a minimum $2,000 ownership requirement.[24] In contrast, Section 844(b) of the Act would require any shareholder wishing to put a proposal on a public company ballot to own at least 1% of the company's stock for a minimum of three years.

For example, Section 844(b) of the Act would require an investor at Wells Fargo to own approximately $2.6 billion in shares in order to file a single proposal. At Apple, the largest U.S. company by market capitalization, a shareholder would have to own more than $7 billion of stock to file a single proposal.

Even our largest public pension fund members rarely hold 1% of a public company.[25] In fact, based on holdings as of December 30, 2016, the only shareholders with eligibility to propose

[23] *See* Ceres et al., The Business Case for the Current SEC Shareholder Proposal Process 6 (Apr. 2017), *available at* https://www.eenews.net/assets/2017/04/27/document_cw_02.pdf; *see also* Statement of New York City Comptroller Scott M. Stringer on the April 19th Discussion Draft of the Financial CHOICE Act of 2017 (Act) 3 (Apr. 25, 2017) (describing some of the many achievements "made possible because of the NYC Pension Funds' long-standing right and ability to file shareholder proposals—a right and ability that would be pointlessly eviscerated by the passage of the Act") (on file with CII); Letter from Thomas P. DiNapoli, State Comptroller, State of New York, Office of the State Comptroller, to the Honorable Jeb Hensarling, Chairman, Committee on Financial Services, United States House of Representatives 1 (Apr. 26, 2017) ("It has been my experience over the past ten years as Comptroller that shareholder resolutions are an effective means to voice concerns and propose changes in order to protect Fund investments and encourage sustainable, robust corporate practices at our portfolio companies.") (on file with CII).

[24] 17 CFR 240.14a-8(b) Question 2.

[25] *See* Letter from Jack Ehnes at 1 (Apr. 25, 2017) ("While 1% may sound like a small amount, even a large investor like the $200 billion CalSTRS fund does not own one percent of publicly traded companies."); Statement of New York City Comptroller at 1 ("Despite being among the largest pension investors in the world, we rarely hold more than 0.5% of any individual company, and most often hold less."); Letter from Thomas P. DiNapoli at 2 ("Such

resolutions at Apple would be BlackRock, Vanguard, State Street, FMR, Northern Trust, Bank of New York Mellon, Berkshire Hathaway and T. Rowe Price. To our knowledge, none of these investors has ever presented a shareholder proposal at an annual meeting.

In addition, current rules permit a shareholder to re-file a proposal only if it has received at least 3% of the vote on its first submission, 6% on the second and 10% on the third.[26] Section 844(a) of the Act would raise those thresholds to 6%, 15% and 30%, respectively. Those hurdles could also knock out many important governance proposals that, if adopted, could enhance long-term shareowner value. The percentages of proposals since 2000 that are estimated to have fallen below the proposed thresholds are 13.3%, 31.5%, and 50.1%, respectively.

We agree with Anne Sheehan, director of corporate governance at the California State Teachers' Retirement System, the second largest U.S. public pension fund, and a CII member, that the provisions of Section 844 of the Act '"would shut down the shareholder proposal process completely.'"[27] Shutting down shareholder proposals is likely to have unintended consequences, including shareowners more often availing themselves of the blunt instrument of votes against directors, and increased reliance on hedge fund activists to push for needed corporate changes.

Universal Proxies

CII opposes Section 845 of the Act because it appears intended to bar the SEC from issuing a final rule that would allow shareowners to freely vote for those board candidates they favor in a contested election.

The problem that the SEC's October 2016 universal proxy proposal[28] would resolve is a problem that was clearly articulated by the SEC's Investor Advisory Committee in 2013.[29] 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.[30]

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severe holding requirements would effectively deprive the Fund, and most other shareholders of the ability to file proposals.").

[26] 17 CFR 240.14a-8(i)(12).

[27] Andrea Vittorio, Shareholder Advocacy Tool Shut Down in Republican Plan, Bloomberg BNA, Apr. 19, 2017, at 2, *available at* https://www.bna.com/shareholder-advocacy-tool-n57982086844/.

[28] Universal Proxies, Exchange Act Release No. 79,164, Investment Company Act Release No. 32,339 (proposed rule Oct. 26, 2016), *available at* https://www.sec.gov/rules/proposed/2016/34-79164.pdf.

[29] Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots 2 (adopted July 25, 2013) ("shareholders [currently] have no practical ability to 'split their tickets' and vote for a combination of shareholder nominees and management nominees), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf.

[30] *Id; see* Letter from Ken Bertsch, Executive Director, Council of Institutional Investors, to Brent J. Fields, Secretary, Securities and Exchange Commission 3, 6-40 (Dec. 28, 2016) (Explaining in detail why the "proposal will facilitate the ability of shareholders to fully exercise their franchise by proxy by allowing them to vote for the combination of nominees of their choice"), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/12_28_16_comment_letter_SEC_universal_proxy.pdf; *see also* Carl Icahn, Statement Regarding SEC Proposal to Require Use of Universal Proxy Cards (Oct. 27, 2016) ("the introduction of the universal proxy card will eliminate needless voter confusion in contested elections,

That view is reflected in 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.[31]

Voting for director nominees is a fundamental right, and as long term investors, our members support the ability to choose among the best suited candidates to represent their interests inside the board room.[32]

Some opponents of universal proxy cards contend their use would encourage more proxy contests or favor dissidents.[33] We are unaware of any compelling empirical evidence indicating that universal proxies would favor shareowner-proponent board nominees over company-nominees (or the reverse).[34] As concluded in a recent expert analysis of the SEC proposal by attorneys with Fried Frank Harris & Jacobson LLP: "In our view, the universal proxy card mandate, if adopted, would not significantly affect the outcome of proxy contests or activist situations." [35]

We also agree with Keith F. Higgins, former SEC Director of Corporation Finance, who recently commented:

> What I haven't heard is a good answer to this simple question: *Why shouldn't a shareholder who votes by proxy have the same voting options as a shareholder who votes in person? Unless someone comes up with a good answer to that question, I think the Commission should move forward with the proposal*, although I note that a prohibition on doing so may be part of version 2.0 of the Financial CHOICE Act being considered by the House Financial Services Committee. Even though there

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give shareholders greater freedom of choice, and hopefully end some of the gamesmanship employed by incumbent boards to keep shareholder-nominated directors out of the boardroom"), *available at* http://carlicahn.com/statement-regarding-sec-proposal-to-require-use-of-universal-proxy-cards/.

[31] §2.2 Director Elections.

[32] *See, e.g.*, Letter from Jack Ehnes at 2.

[33] Gail Weinstein et. al., Fried Frank Harris Shriver & Jacobson LLP, Expert Analysis, A Practical Assessment of the 'Universal Proxy Card' Plan, Law360, at 4 (Dec. 14, 2016) ("Opposition to a Universal Proxy Card Mandate Has Centered on Concerns That It Will Lead to More Proxy Contests and Increased Leverage for Activists"), *available at* http://www.friedfrank.com/siteFiles/Publications/A%20Practical%20Assessment%20Of%20The%20'Universal%20Proxy%20Card'%20Plan.pdf.

[34] *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/.

[35] Gail Weinstein et. al. at 6 (emphasis omitted).

> are only a relatively small number of contested elections each year, *it is a glitch in the system of fair suffrage that should be fixed*.[36]

Internal Controls

CII opposes Section 847 of the Act because it would further expand the existing exemption for public corporations from 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 of 2002.

We note that Section 989G of Dodd-Frank currently provides a permanent exemption from an independent attestation of internal controls over financial reporting for those public companies whose market capitalization is less than $75 million. Section 847 of the Act would raise the Dodd-Frank exemption to include public companies with market capitalizations of less than $500 million or less than $1 billion in assets for banks.

We note, by example, that there are currently about 680 public companies in the Russell 2000 Index that have market capitalizations of less than $500 million. As a result, if the provisions of the Act became law, investors in those 680 companies, which includes many of our members, would not have the protection of an outside independent auditor's attestation of the company's internal controls over its financial statements.[37] While we, and many of our members, appreciate that cost of compliance with Section 404(b) is often cited as a concern by some small issuers, we believe the benefits to investors from an independent attestation of a public company's internal controls over financial reporting exceeds those costs.[38]

As we explained in a recent joint letter to the SEC with the Center for Audit Quality:

> 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

[36] Keith F. Higgins at 2.
[37] *See, e.g.*, Letter from Jack Ehnes at 2.
[38] *Id.*

> obtained an auditor attestation generally had fewer financial restatements than those that did not.
>
> 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.
>
> 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% 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.[39]

<u>Clawbacks</u>

CII opposes Section 849 of the Act because it would narrow the scope of required clawbacks of unearned compensation from corporate executives to only those we had control or authority over the company's financial reporting.

We continue to support the SEC's issuance of a final rule in response to Section 954 of Dodd-Frank entitled, "Recovery of Erroneously Awarded Compensation." The SEC's proposed rule to implement Section 954 is generally consistent with CII's membership approved corporate governance policies.[40] 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.[41]

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[39] Letter from Cynthia M. Fornelli, Executive Director, Center for Audit Quality & Jeff Mahoney, General Council, Council of Institutional Investors, to U.S. Securities and Exchange Commission 2-3 (Aug. 30, 2016) (footnotes omitted), *available at* https://www.sec.gov/comments/s7-12-16/s71216-17.pdf.

[40] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (proposed rule July 14, 2015), *available at* https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.

[41] § 5.5 Pay for Performance.

Consistent with our policies, we believe a final SEC rule should be issued, and as proposed,[42] applying 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.[43] 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.[44]

We note that broad clawback arrangements may "keep executive officers focused on sound accounting company-wide."[45] We also note that if the limitation of Section 849 were enacted, employees such as the former head of community banking at Wells Fargo, Carrie L. Tolstedt, would presumably not fall within the scope of the required clawback.[46]

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.[47] Those principles state that "companies should maintain clawback policies for both cash and equity compensation" of management.[48]

Hedging

CII opposes Section 857(a)(25) of the Act because it would repeal the requirement that public corporations disclose whether their employees and directors can hedge their company's equity compensation.

We continue to support the SEC's issuance of a final rule in response to Section 955 of Dodd-Frank entitled, "Disclosure Regarding Employee and Director Hedging." The SEC's proposed

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[42] *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").
[43] 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;
[44] *Id.* (footnotes omitted).
[45] Testimony of Michael S. Barr at 15.
[46] Nathan Bomey & Kevin McCoy, Wells Fargo clawing back $75.3 million more from former execs in fake accounts scandal, USA Today, Apr. 10, 2017, at 1 (reporting that "the bank has canceled $47.3 million in additional stock options owed to Carrie Tolstedt, who previously headed the community banking division where the scandal erupted"), *available at* https://www.usatoday.com/story/money/2017/04/10/wells-fargo-compensation-clawback/100276472/.
[47] Commonsense Corporate Governance Principles VII(g) (July 2016), *available at* http://www.governanceprinciples.org/.
[48] *Id.*

rule to implement Section 955[49] has important implications for CII's long-standing membership approved corporate governance policies on hedging of compensation.[50] 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 other stock holdings in the company. And they should strongly discourage other employees from hedging their holdings in company stock.[51]

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 SEC, "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."[52] Moreover, we generally agree with the SEC that given its narrow focus, it is unlikely that the proposed disclosure would "impose a significant compliance burden on [those] companies."[53]

Finally, we believe the proposed disclosure also would benefit our members and other investors because the public nature of the required disclosure would likely result in more companies adopting our hedging policy and potentially improving the linkage of pay to performance and enhancing long-term shareowner value. For all the above reasons, CII opposes Section 857(a)(25) of the Act and generally supports the SEC's issuance of a final rule as proposed.[54]

Compensation Structure

CII opposes Section 857(a)(26) of the Act because it would repeal requirements to improve executive pay practices at certain financial institutions.

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[49] Disclosure of Hedging by Employees, Officers, and Directors, 80 Fed. Reg. 8486 (proposed Feb. 17, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-02-17/pdf/2015-02948.pdf.
[50] § 5.8d Hedging.
[51] *Id.*
[52] 80 Fed. Reg. at 8494.
[53] *Id.*
[54] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, 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.

We continue to support the issuance of a final rule by the SEC and the federal financial regulators in response to Section 956 of Dodd-Frank entitled, "Enhanced Compensation Structure Reporting." As we stated in our comment letter in response to the proposed rule to implement Section 956,[55] the proposal is "largely consistent with CII's member-approved policies on executive compensation."[56] Those policies support 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.[57] In light of those policies and the experience of the financial crisis,[58] 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.[59]

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.

Proxy Access

CII opposes Section 857(a)(30) of the Act because it would repeal express authority of the SEC to issue a proxy access rule.

Section 971 of Dodd-Frank gave the SEC the express authority to develop a proxy access rule that the SEC subsequently finalized.[60] The rule, however, was struck down in 2011 on administrative procedure grounds in a controversial decision by a three judge panel of the DC Circuit.[61]

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[55] 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.
[56] 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.
[57] § 5.1 Introduction.
[58] 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.
[59] Letter from Glenn Davis at 3.
[60] Facilitating Shareholder Director Nominations, Securities Act Release No. 9,136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384 (Aug. 25, 2010), *available at* https://www.sec.gov/rules/final/2010/33-9136.pdf.
[61] *See, e.g.*, Jessica Holzer, Court Deals Blow to SEC, Activists, Wall St. J., July 23, 2011, at 1 (July 23, 2011), *available at* https://www.wsj.com/articles/SB10001424053111903554904576461932431478332.

We continue to 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. Without effective proxy access, the director election process at many companies simply offers little more than a ratification of management's slate of nominees.

Our 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 3% 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.[62]

We generally support an approach to proxy access similar to the one that the SEC adopted in 2010 but was later vacated.[63] We note that now more than 400 U.S. public companies have voluntary adopted proxy access in a form generally consistent with our policy.[64] That includes 11% of the Russell 3000, constituting more than half of the index's total market capitalization, and about half of the S&P 500. [65]

The companies that have 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.[66]

Relying on private ordering rather than a uniform approach envisaged by the SEC in 2010 has led to myriad versions of proxy access, at greater legal expense than with a uniform rule, and with the potential for various creative provisions that seem aimed at making it difficult for shareowners to use the mechanism.[67] Given the clear growing trend of public companies adopting proxy access, and the increasing complexity and related costs resulting from the current private ordering process, there may soon come a time when companies and their shareowners will favor a more uniform, less costly, set of requirements for proxy access. If that time should arrive, Section 971 of Dodd-Frank would facilitate the SEC's ability to respond with rulemaking in a more timely and cost-effective manner.

Chairman & CEO Structures

CII opposes Section 857(a)(31) of the Act because it would repeal required disclosures of a public corporation's Chairman and CEO structures.

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[62] § 3.2 Access to Proxy.
[63] *See* Facilitating Shareholder Director Nominations at 24-34 (summarizing the final rule requirements).
[64] CII, Proxy Access Bylaws, Company-Specific Details on Access Mechanisms Gathered by Covington & Burling (last updated Mar. 31, 2017), *available at* http://www.cii.org/proxy_access.
[65] *See* CII, Proxy Access by Private Ordering 2 (Feb. 2017), *available at* http://www.cii.org/files/publications/misc/02_02_17_proxy_access_private_ordering_final.pdf.
[66] Proxy Access Bylaws.
[67] Proxy Access by Private Ordering at 10.

We note that the SEC adopted rules in December 2009 that, in effect, implemented the disclosure requirements of Section 972 of Dodd Frank entitled, "Disclosures Regarding Chairman and CEO Structure." CII's membership approved policies generally support appointment of an independent chair and related disclosure. 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.

CII members believe that board leadership is critical to effective governance. We believe that even those who promote combination of chair and CEO roles generally share that view, and should have no objections to the existing disclosure requirements providing for clarity around the reasoning behind board leadership structure.

Finally, we note that our support for this existing disclosure requirement appears to be generally consistent with the "Commonsense Principles of Corporate Governance" recently endorsed by a number of prominent leaders of U.S. public companies.[68] Those principles state that the "board should explain clearly . . . to shareholders why it has separated or combined the roles [of CEO and Chair]."[69]

<u>Governmental Accounting Standards Board (GASB)</u>

CII opposes Section 857(a)(34) of the Act because it repeals an existing market-based, independent accounting support fee for the GASB.

As we explained in a recent letter to you on this topic:

> On behalf of . . . CII, we write to urge you exclude from the Financial CHOICE Act any provision that repeals section 978 of . . . Dodd-Frank . . . that provides a funding mechanism for the . . . GASB.
>
> . . . .
>
> The GASB funding mechanism currently in place provides the GASB with an independent, conflict-free source of funds in order to carry out its important mission

[68] Commonsense Corporate Governance Principles at V(a).
[69] *Id*.

> of establishing accounting and financial reporting standards for U.S. state and local governments that follow Generally Accepted Accounting Principles (GAAP). The independent and predictable source of funds that GASB receives benefits taxpayers and investors because it is free of the conflicts of interest, real or perceived, that were inherent in GASB's old funding source that required GASB's parent, the Financial Accounting Foundation, to solicit voluntary contributions from the very entities that would be bound by its accounting standards. We should not go back to this practice that undermines investor confidence.
>
> We support the GASB's important work and urge you to exclude any provision in your legislation that repeals GASB's current funding mechanism.[70]

Private Equity

CII opposes Sections 858-859 of the Act because it would remove transparency in private equity by requiring the SEC to exempt advisors to private equity funds from registration and reporting.

We continue to agree with the 2009 recommendation of the Investor Working Group that all investment managers of funds available to U.S. investors, including private equity funds, should be required to register with the SEC as investment advisers and be subject to oversight and disclosure requirements.[71] As has been widely reported, the existing registration and reporting requirements for advisers to private equity funds has led "firms such as KKR, Blackstone and Apollo Global Management LLC Group to [pay] . . . tens of millions in fines . . . after SEC examinations uncovered what regulators said were insufficient disclosures of some fee and expense practices to clients."[72] Those actions have expedited the elimination of certain types of fund advisor fees that many of our members regard as inappropriate, such as monitoring fees charged by certain private equity fund advisers.[73]

We understand that Sections 858-859 of the Act would authorize the SEC to issue rulemaking regarding certain types of records that private equity fund advisers must keep. We, however, remain concerned that the Act's provisions to eliminate registration and reporting requirements for advisors to private equity funds would inhibit the SEC's investor protection efforts in the

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[70] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Jeb Hensarling, Chairman, Committee on Financial Services, U.S. House of Representatives 1-2 (Feb. 9, 2017) (footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/February%209,%202017%20GASB.pdf.

[71] Investors Working Group at 16 ("All investment advisers and brokers offering investment advice should have to meet uniform registration requirements, regardless of the amount of assets under management, the type of product they offer or the sophistication of investors they serve . . . [e]xemptions from registration should not be permitted").

[72] *See, e.g.*, Melissa Mittelman, Private Equity Eyes Tax and Financial Reform in the Trump Era, Bloomberg, Jan. 19, 2017, at 3, *available at* https://www.bloomberg.com/news/articles/2017-01-19/with-close-trump-ties-private-equity-eyes-tax-financial-reform.

[73] *See, e.g.*, Jack Ehnes at 3.

private equity industry, disadvantage fund managers that currently follow best practices, as well as unnecessarily expose investors and all taxpayers to potentially greater systemic risks.[74]

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Thank you for considering our views on the Act. We would be very happy to discuss our perspective on these and other 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

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[74] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Paul D. Ryan, Speaker, United States House of Representatives et al. 1-2 (Sept. 7, 2016) (opposing proposed legislation that would roll back transparency and reporting requirements for private equity funds because it would inhibit the ability to monitor systemic risk and protect investors), *available at* www.cii.org/files/issues_and_advocacy/correspondence/2016/Sept%207%202016%20Letter%20to%20Speaker%20regarding%20H%20R%20%205424%20(003).docx%20(final).pdf.