Council of Institutional Investors®
The voice of corporate governance

Via Hand Delivery

February 27, 2019

The Honorable Michael D. Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: February 28, 2019 Hearing on Legislative Proposals on Capital Formation and Corporate Governance[1]

Dear Mr. Chairman and Ranking Member Brown:

I am writing on behalf of the Council of Institutional Investors (CII) to express our appreciation for holding the above referenced hearing and to provide you with our views on several corporate governance related topics that are of great interest to our members that we understand may be discussed at the hearing. We would respectfully request that this letter be made a part of the hearing record.

CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 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 $35 trillion in assets under management.[2]

---

[1] Hearings, United States Committee on Banking, Housing, and Urban Affairs, Legislative Proposals on Capital Formation and Corporate Governance (Feb. 28, 2019), https://www.banking.senate.gov/hearings/legislative-proposals-on-capital-formation-and-corporate-governance.
[2] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

1717 Pennsylvania Avenue, NW | Suite 350 | Washington, DC 20006 | Main 202.822.0800 | Fax 202.822.0801 | www.cii.org

Rule 10b5-1 Trading Plans

CII supports H.R. 624, the Promoting Transparent Standards for Corporate Insiders Act.[3]

For years, we have heard and read accounts about corporate insiders violating the spirit of the Securities and Exchange Commission's (SEC) Rule 10b5-1,[4] apparently in at least some cases in efforts to provide cover for improper stock trades while possessing material non-public information.[5] *The Wall Street Journal* published a series of articles in 2012 that highlighted suspiciously fortuitous trading patterns under Rule 10b5-1 plans adopted by corporate insiders.[6] Empirical research by academics have found similar results.[7]

In December 2012, at the recommendation and with the assistance of a prominent corporate/securities lawyer, CII submitted a rulemaking petition to the SEC recommending improvements to Rule 10b5-1.[8] Those improvements were specifically designed to limit the

---

[3] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Maxine Waters, Chairman, House Committee on Financial Services 1 (Jan. 22, 2019) ("I am writing on behalf of . . . CII[] to express our strong support for H.R. 624"), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/January%2022,%202019%20Rule%2010b5-1%20Letter%20final.pdf.

[4] Trading "On the Basis Of" Material Nonpublic Information in Insider Trading Cases, 17 C.F.R. § 240.10b5-1 (Aug. 2000), *available at* https://www.law.cornell.edu/cfr/text/17/240.10b5-1.

[5] *See, e.g.,* Craig M. Scheer, Rule 10b5-1 Trading Plans in the Current Environment: The Importance of Doing it Right, Bus. Law Today (Sept. 19, 2018) ("Critics have long viewed the rule as creating an opportunity for abuse, claiming that some insiders may in fact be aware of material non-public information at the time plans are established and that the rule can be used to provide cover for improper trades."), http://apps.americanbar.org/buslaw/blt/content/2013/02/article-06-scheer.shtml.

[6] Jean Eaglesham & Rob Barry, Trading Plans Under Fire, Wall. St. J., Dec. 13, 2012 ("the SEC is facing mounting pressure to tighten its rules, following a[n] . . . investigation that found profitable and well-timed trades by more than 1,400 executives."), https://www.wsj.com/articles/SB10001424127887324296604578177734024394950; Justin Lahart, Timing Is Everything for Insider Sales, Wall. St. J., Nov. 28, 2012 ("There is substantial wiggle room within 10b5-1 plans—for example, their existence doesn't have to be disclosed, and they can be canceled or changed without disclosure, as well."), https://www.wsj.com/articles/SB10001424127887324020804578147261230632772; Susan Pulliam & Rob Barry, Executives' Good Luck in Trading Own Stock, Wall. St. J., Nov. 27, 2012 (initial reporting on investigation finding that more than 1,400 executives, including some with 10b5-1 plans, had made usually beneficial trades), https://www.wsj.com/articles/SB10000872396390444100404577641463717344178; *see, e.g.,* Cydney Posner, Blog: New House Bill to Curb Potential Abuse of 10b5-1 Plans, PubCo@Cooley (Jan. 25, 2019) ("Commenting that the articles "identified a number of problems with 10b5-1 plans, including the absence of public disclosure about the plan or changes to it and the absence of rules about how long the plans must be in place before trading under the plans can begin."), https://www.jdsupra.com/legalnews/blog-new-house-bill-to-curb-potential-19688/.

[7] *See* John Shon & Stanley Veliotis, Insiders' Sales Under Rule 10b5-1 Plans and Meeting or Beating Earnings Expectations, 59(9) Mgmt. Sci. iv (Sept. 2013) ("One interpretation of our results is that CEOs and CFOs who sell under these plans may be more likely to engage in strategic behavior to meet or beat expectations in an effort to maximize their proceeds from plan sales."), https://pubsonline.informs.org/doi/abs/10.1287/mnsc.1120.1669?journalCode=mnsc.; *see also* Cydney Posner ("The problem is—and of course there's a problem—that academic studies uncovered a statistical link between the timing of executive sales under Rule 10b5-1 plans and negative corporate news, finding that executives using 10b5-1 plans generated significantly better returns than other executives at the same company.").

[8] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Elisse B. Walter, Chairman, U.S. Securities and Exchange Commission (Dec. 28, 2012), http://www.cii.org/files/issues_and_advocacy/correspondence/2012/12_28_12_cii_letter_to_sec_rule%20_10b5-1_trading_plans.pdf.

opportunity for executives to continue to abuse the rule and were derived, in part, from our membership approved policies.[9]

Despite our repeated requests, the common-sense improvements to Rule 10b5-1 that we first recommended in 2012,[10] have not been adopted.[11] As a result, gaping loopholes in the rule remain that we believe will likely continue to be subject to abuse.[12]

H.R. 624

CII's recommended improvements to Rule 10b5-1 have been incorporated into the SEC study of Rule 10b5-1 that would be mandated by H.R. 624.[13] As you are aware, on January 28, 2019, the United States House of Representatives (House) approved H.R. 624 by a vote of 413 to 3. Prior to the vote, Representatives from both parties expressed support for the bill on the House floor. For example, bill co-sponsor and Committee on Financial Services Ranking Member Patrick T. McHenry stated:

> Mr. Speaker, I rise in support of H.R. 624, the promoting transparency standards for corporate insider act. This bipartisan legislation is critical for protecting mom and pop investors from the effects of insider trading, while ensuring that the rules are clear, fair and not unduly burdensome. I want to first thank chairwoman Waters for her sponsorship of this bill and for writing this legislation.[14]

We agree with Representative McHenry's statement. We welcome the opportunity to work with you and the Committee on Banking, Housing, and Urban Affairs (Committee) in support of this important bi-partisan legislation that we believe will benefit capital formation and improve corporate governance.

---

[9] *Id.* at 3 (proposed improvements include "imposing a minimum period between the adoption of a Rule 10b5-1 plan and the execution of trades pursuant to such plan, . . . restricting plan modifications and cancellations . . . [and] making boards explicitly responsible for the oversight of Rule 10b5-1 plans"); *see* Council of Institutional Investors, Corporate Governance Policies, § 5.15b Stock Sales (updated Oct. 24, 2018) ("10b5-1 program adoptions, amendments, terminations and transactions should be disclosed immediately, and boards of companies using 10b5-1 plans should: (1) adopt policies covering plan practices, (2) periodically monitor plan transactions and (3) ensure that company policies discuss plan use in the context of guidelines or requirements on equity hedging, holding and ownership."), https://www.cii.org/files/10_24_18_corp_gov_policies.pdf.

[10] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 1, 8 (Dec. 13, 2018) (requesting that the Securities and Exchange Commission make a priority of proposing amendments to 10b5-1 and referencing some of the prior CII correspondence on the issue), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/December%2013%202018%20SEC%20Reg%20Flex%20Letter.pdf.

[11] *See, e.g.,* Cydney Posner ("No action to amend the Rule was taken by the SEC at the time.").

[12] *See, e.g.,* Ken Kam, 2 CEOs Who Have Not Earned My Trust, Forbes (Feb. 17, 2019) ("the fact is [in October 2017, after changing his 10b5-1 trading plan, the former chief executive officer of Intel Corp. Brian] Krzanich sold every share [of Intel stock] he could and still remain CEO about a month before the security vulnerabilities of Intel's processors became public knowledge."), https://www.forbes.com/sites/kenkam/#67d443111f0f.

[13] *See* Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, 116th Cong. § 2(a)(1) (2019), https://www.congress.gov/bill/116th-congress/house-bill/624.

[14] *Id.* (statement of Rep. McHenry) (on file with CII).

Multi-Class Stock Structures

CII supported H.R. 6322, the Enhancing Multi-Class Stock Disclosure Act in the 115th Congress.[15]

The principle of open-share, one vote is a foundation of good corporate governance and equitable treatment of investors. CII believes public companies should provide all shareholders with voting rights proportional to their holdings.

While the first policy adopted by CII in 1985 endorsed one-share, one-vote,[16] CII members have since approved a statement on expectations for newly public companies that calls for those using unequal voting structures to adopt sunset mechanisms that revert to one-share, one-vote within a reasonably limited period.[17]

In October 2018, three months following our first public support of H.R. 6322, we filed petitions with the New York Stock Exchange (NYSE)[18] and the NASDAQ Stock Market (NASDAQ),[19] asking both to limit listings of companies with dual-class share structures. Our petitions request the NYSE and the NASDAQ to amend their listing standards to require that, going forward, companies seeking to list that have multiple share classes with differential voting rights include in their governing documents provisions that convert the share structure within seven years of the initial public offering (IPO) to one-share, one vote, consistent with our membership approved policies.[20]

The petitions are supported by many institutional investors, such as BlackRock, the California State Teachers Retirement System, the California Public Employees' Retirement System, the State

---

[15] *See* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Jeb Hensarling, Chairman, Committee on Financial Services et al. (July 10, 2018) ("We . . . generally support the EMS Act."), https://www.cii.org/files/July%2010%202018%20Letter%20to%20Committee%20on%20Financial%20Services(1).pdf.

[16] § 3.3 Voting Rights ("Each share of common stock should have one vote[] [and] [c]orporations should not have classes of common stock with disparate voting rights.").

[17] Council of Institutional Investors, Investor Expectations for Newly Listed Companies ("Upon going public, a company should have a 'one share, one vote' structure' [and] . . . CII expects newly public companies without such provisions to commit to their adoption over a reasonably limited period through sunset mechanisms.'), https://www.cii.org/ipo_policy.

[18] Letter from Ash Williams, Chair, CII et al. to Elizabeth King, Chief Regulatory Officer, Intercontinental Exchange Inc. (Oct. 24, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NYSE%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf.

[19] Letter from Ash Williams, Chair, CII et al. to John Zecca, Senior Vice President, General Counsel North America and Chief Regulatory Officer, NASDAQ Stock Market (Oct. 24, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf.

[20] Press Release, Investors Petition NYSE, NASDAQ to Curb Listings of IPO Dual-Class Share Companies 1 (Oct. 24, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/FINAL%20Dual%20Class%20Petition%20Press%20Release%20Oct%2024,%202018.pdf.

Board of Administration of Florida and T. Rowe Price.[21] Generally consistent with our petitions, some multi-class companies in recent years have chosen to mitigate the effects of unequal voting rights by incorporating meaningful sunset provisions.

For example, last year, EVO Payments, Bloom Energy and Smartsheet held dual-class IPOs with three-, five- and seven-year sunsets, respectively. Other recognizable technology companies to take this approach include Groupon, which went public in 2011 with a five-year sunset and successfully collapsed its unequal voting structure in 2016; MaxLinear, which went public in 2010 with a seven year sunset and reverted to one-share, one-vote in 2017; Yelp, which went public in 2012 with a seven year sunset and collapsed its dual-class structure two years early in 2017; and Mulesoft, Kayak, Apptio and Mindbody, all of which went public with sunsets of seven years or less and were acquired before those provisions were triggered.[22]

One recent study of dual-class company performance found that even at innovative companies where unequal voting structures correlate to a value premium at the time of the IPO, that premium dissipates within six to nine years before turning negative.[23] Another study found that dual-class structures correlate with more innovation and value creation in the period shortly after an IPO, but within six to 10 years, the costs of the unequal voting structures outweigh the benefits.[24]

Based on the experience of numerous multi-class companies specifically, and the results of empirical research generally, we believe a sunset of seven years or less affords an appropriate period to harness whatever benefits of innovation and control a multi-class structure may provide while mitigating the agency costs it imposes over time. We remained convinced that one-share, one-vote is the best model for sustainable value creation in the long-term. As SEC Commissioner Robert J. Jackson Jr. said in a February 2018 speech, "If you run a public company in America, you're supposed to be held accountable for your work—maybe not today, maybe not tomorrow, but someday."[25]

[21] *See id.* at 1-2; Letter from Aeisha Mastagni, Interim Co-Director of Corporate Governance, California State Teachers' Retirement System to Elizabeth King, Chief Regulatory Officer, Intercontinental Exchange Inc. 1 (Nov. 30, 2018) ("I am writing on behalf of . . . CalSTRS to support . . . CII petition to the NYSE on multi-class common stock structures."), https://www.calstrs.com/sites/main/files/file-attachments/2018-11-30_sunset_multiclass_shares_nyse.pdf; Letter from Ashbel Williams, Executive Director, State Board of Administration of Florida to John Zecca, Senior Vice President, General Counsel North America and Chief Regulatory Officer, NASDAQ Stock Market 1 (Nov. 9, 2018) ("SBA of Florida is writing to enthusiastically endorse the October 24, 2018, petition from . . . CII to the NASDAQ requesting a listing standard to require a time-based sunset on any new listing of multi-class shares with differential voting rights.") (on file with CII).
[22] Council of Institutional Investors, Companies with Time-Based Sunset Approaches to Dual-Class Stock (updated Feb. 13, 2019), https://www.cii.org/files/2-13-19%20Time-based%20Sunsets.pdf.
[23] Martijn Cremers et al., The Life-Cycle of Dual Class Firms 1, 40 (ECGI, Working Paper No. 550/2018) ("We also find that the initial dual class valuation premium is temporary, and on average it disappears within 6 to 9 years after the IPO, depending on the proxy for firm value used [and] [t]he declining valuations of dual- versus single-class firms and the eventual average valuation discount may provide tentative support for a mandatory sunset provision for dual class structures, as advocated by Bebchuk and Kastiel (2017)"), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895.
[24] Lindsay Baran et al., Dual Class Share Structure and Innovation (Sept. 10, 2018) (concluding that their findings lend credence to the view that if dual class structures should be allowed at all, they should face rigorous sunset provisions post-initial public offering), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517.
[25] Commissioner Robert J. Jackson Jr., Speech, Perpetual Dual-Class Stock: The Case Against Corporate Royalty (Feb. 5, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty.

Public company investors have demonstrated time and again that they will support innovation and investment for the long term, as has been the case for decades at Amazon, Apple and many other companies. While establishing accountability to new owners does not always maximize comfort and compensation for management, we believe accountability is important for performance longer term, especially through bumps in the road that every company will experience.

H.R. 6322

The provisions of H.R. 6322 would amend the Securities Exchange Act of 1934 "to require issuers with multi-class stock structures to make certain disclosures in any proxy or consent solicitation material with respect to each person who is a director or executive officer of the issuer or who, directly or indirectly, holds five percent or more of the total combined voting power of all classes of stock entitled to vote in the election of directors."[26] We note that those disclosures are generally consistent with a recommendation of the Investor as Owner Subcommittee of the SEC Investor Advisory Committee.[27]

We believe that improving disclosure about public companies with multi-class stock structures is an important supplement to amending existing U.S. stock exchange listing standards to require meaningful, time-based sunsets.[28] In that regard, while we continue to support the provisions of H.R. 6322, we believe the Committee should consider two modest improvements to the provisions of the bill.

First, the Committee should consider amending the provisions of H.R. 6322 to require issuers with multi-class stock structures to supplement existing disclosure of aggregate proxy vote results in SEC Form 8-K with a breakdown of those results by each share class.[29] This proposed amendment would provide investors and other market participants with greater transparency

---

[26] Memorandum from Financial Services Majority Staff, to the Members of the Committee on Financial Services 4 (July 6, 2018) (on file with CII).

[27] U.S. Securities and Exchange Commission, Investor Advisory Committee, Recommendation of the Investor as Owner Subcommittee, Dual Class and Other Entrenching Governance Structures in Public Companies 6 (Feb. 27, 2018) ("Require public companies that have dual class or other entrenching governance structures to prominently and clearly disclose the numerical relationship between (a) the amount of common equity or its equivalent economic beneficial ownership interest held by any person entitled to control or direct the voting of five percent or more of shares entitled to voting rights in the election of directors or the equivalent body . . . and (b) the amount of voting rights held or controlled by such a person . . . ."), https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac030818-investor-as-owner-subcommittee-recommendation.pdf.

[28] *See* Press Release, CII Applauds Shareholder Protections in House Bill (July 17, 2018) (Commenting that the H.R. 6322 "disclosures would shed more light on certain shareholders' voting power, which CII views as an important supplement to amending existing U.S. stock exchange listing standards to require meaningful, time-based sunsets for newly listed companies with those structures."); Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields Secretary, Securities and Exchange Commission 3 (Dec. 20, 2017) ("We believe that improving investor access to information about classes of stock with different or preferential voting rights is an important intermediate step to amending existing U.S. listing standards to adopt the core governance principle of 'one share, one vote.'"), https://www.cii.org/files/issues_and_advocacy/correspondence/2017/December%2020,%202017%20SEC%20FAST%20Act%20letter%20(final)%20.pdf.

[29] Securities and Exchange Commission, Form 8-K, Item 5.07 Submission of Matters to a Vote of Security Holders (Sept. 2017), https://www.sec.gov/about/forms/form8-k.pdf.

regarding the impact of multi-class stock structures on the proxy voting results of critical corporate governance issues, including the election of directors.

Second, the Committee should consider amending H.R. 6322 to grant the SEC explicit authority to promulgate rules related to multi-class stock structures under such terms and conditions as the SEC determines are in the interests of shareholders and for the protection of investors. That authority was called into question as the result of a controversial 1990 D.C. Circuit Court decision.[30] If the stock exchanges should fail to act on CII's petitions, this proposed amendment would permit the SEC to more successfully avoid or defend potential litigation by special interest groups challenging its power to issue rules that would facilitate public company adoption of the core corporate governance principle of one-share, one-vote.

Cybersecurity Disclosure

CII supported S. 536, the Cybersecurity Disclosure Act of 2017 in the 115th Congress.[31]

CII believes that cybersecurity is an integral component of a board's role in risk oversight.[32] Directors have the authority, capacity and responsibility to make pivotal contributions in this area by ensuring adequate resources and management expertise are allocated to robust cyber risk management policies and practices, and ensuring disclosure fairly and accurately portrays material cyber risks and incidents.[33] To achieve these objectives, directors need to:

- Understand management's cybersecurity strategy;
- Learn where cybersecurity weaknesses lie; and
- Support informed, reasonable investment in the protection of critical data and assets.[34]

We agree with SEC Chairman Jay Clayton that "it is important that investors are sufficiently informed about the material cybersecurity risks and incidents affecting the companies in which

---

[30] Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (holding that it was in excess of the Securities and Exchange Commission's authority under § 19 of the Securities Exchange Act of 1934 to issue a rule barring stock exchanges from listing stock of a corporation that takes any corporate action "with the effect of nullifying, restricting or disparately reducing the per share voting rights of [existing common stockholders]."), *available at* *https://h2o.law.harvard.edu/cases/2956; see* Commissioner Robert J. Jackson Jr., Speech, Perpetual Dual-Class Stock: The Case Against Corporate Royalty at n.6 ("The SEC, led at the time by Chairman Arthur Levitt, attempted to intervene—but was thwarted by a controversial ruling of the D.C. Circuit.").

[31] *See* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Michael Crapo, Chairman, Committee on Banking, Housing, and Urban Affairs et al. 7 (June 27, 2018) ("CII strongly supports the stated goal of the bill to 'promote transparency in the oversight of cybersecurity risks at publicly traded companies.'"), https://www.cii.org/files/June%2027%202018%20Letter%20to%20Senate%20Banking%20(final).pdf.

[32] *See* Council of Institutional Investors, Prioritizing Cybersecurity, Five Investor Questions for Portfolio Company Boards 2 (Apr. 2016), https://www.cii.org/files/publications/misc/4-27-16%20Prioritizing%20Cybersecurity.pdf; *see generally* Christophe Veltsos, How to Get Directors on Board with Cyber Risk Governance, SecurityIntelligence, July 9, 2018 (discussing insights into guiding principles for directors to "improve level of engagement around cyber risk governance"), https://securityintelligence.com/how-to-get-directors-on-board-with-cyber-risk-governance/.

[33] Council of Institutional Investors, Prioritizing Cybersecurity at 2.

[34] *Id.*

they invest."[35] We commend the SEC for issuing a statement and interpretative guidance last February to assist public companies in preparing disclosures about cybersecurity.[36] We also commend Chairman Clayton for prioritizing cybersecurity risks in the SEC's examinations of market participants.[37]

S. 536

As you are aware, S. 536 directs the SEC to issue final rules requiring a registered issuer to:

- Disclose in its mandatory annual report or annual proxy statement whether any member of its governing body has expertise or experience in cybersecurity, including details necessary to describe fully the nature of that expertise or experience; and
- If no member has such expertise or experience, describe what other company cybersecurity steps were taken into account by the persons responsible for identifying and evaluating nominees for the governing body.[38]

We note that at a Committee hearing last June, John C. Coates IV, professor of law and economics at Harvard Law School, testified in support of S. 536 stating:

> S. 536 is well designed. It does not attempt to second-guess SEC guidance and rules regarding disclosures generally, or even as to cyber-risk overall. The bill simply asks publicly traded companies to disclose whether a cybersecurity expert is on the board of directors, and if not, why one is not necessary. To be clear, the bill does not require every publicly traded company to have a cybersecurity expert on its board. Publicly traded companies will still decide for themselves how to tailor their resources to their cybersecurity needs and disclose what they have decided. Some companies may choose to hire outside cyber consultants. Some may choose to boost cybersecurity expertise on staff. And some may decide to have a cybersecurity expert on the board of directors.[39]

We generally agree with Professor Coates' comments and support the stated goal of S. 536 to "promote transparency in the oversight of cybersecurity risks at publicly traded companies."[40]

---

[35] Chairman Jay Clayton, Speech, SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 8, 2018), https://www.sec.gov/news/speech/speech-clayton-120618.
[36] Press Release 2018-22, SEC Adopts Statement and Interpretative Guidance on Public Company Cybersecurity Disclosures (Feb. 21, 2018), https://www.sec.gov/news/press-release/2018-22.
[37] Chairman Jay Clayton, Speech, SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks.
[38] *See* S. 536, 115th Cong. § 2 (Mar. 7, 2017), https://www.congress.gov/115/bills/s536/BILLS-115s536is.pdf.
[39] Legislative Proposals to Examine Corporate Governance: Hearing Before the S. Comm. on Banking, Hous. & Urban. Affairs (June 28, 2018) (testimony of Prof. John C. Coates IV, John F. Cogan, Jr. Prof. of Law & Econs., Harv. L. Sch.), https://www.banking.senate.gov/imo/media/doc/Coates%20Testimony%206-28-18.pdf.
[40] S. 536*; see, e.g.,* Letter from Ken Bertsch, Executive Director, Council of Institutional Investors to The Honorable Jack Reed, United States Senate 1 (July 7, 2017), https://www.cii.org/files/07_07_17%20letter%20to%20Senator%20Reed.pdf.

The Proxy Process

CII currently does not support any legislative proposals relating to the proxy process for U.S. public companies.

As you are aware, the SEC continues to solicit comments in connection with its November 15, 2018 public roundtable[41] on the proxy process (Roundtable).[42] On January 31, 2019, CII issued a letter to the SEC (January Letter)[43] as a supplement to our initial comment on the proxy process submitted November 8, 2018 (November Letter).[44]

On February 5, 2019, Chairman Clayton publicly stated in connection with a meeting of the SEC Investor Advisory Committee:

> *Proxy Plumbing*. Turning to the proxy solicitation and voting process (or proxy plumbing), I think there is broad agreement that the current system needs a major overhaul. As I mentioned previously, I am interested in suggestions for what such an overhaul would entail. I am also interested in ideas for what the Commission can do in the interim (short of a total overhaul) to improve the current system . . . .
>
> I am delighted to report that I have asked Commissioner Roisman to take the lead on efforts to consider improvements to the proxy process generally, including proxy plumbing, and I am even more delighted that Commissioner Roisman has agreed to take up this task.[45]

On February 12, 2019, CII staff met with Commissioner Elad L. Roisman at the request of Chairman Clayton to discuss the January Letter. Based on that meeting, and our prior interactions with Mr. Roisman in his roles as Chief Counsel and Securities Counsel for the Committee, we are confident that he can successfully lead the SEC's efforts to improve the current proxy system for the benefit of investors and the capital markets.

The following is a brief summary of our proposed approach to improving the proxy system that we discussed with Commissioner Roisman. That approach is described in more detail in the January Letter.

---

[41] U.S. Securities and Exchange Commission, Proxy Process, November 15, 2018: Roundtable on the Proxy Process (last visited Feb. 23, 2019), https://www.sec.gov/proxy-roundtable-2018.

[42] Chairman Jay Clayton, Remarks for Telephone Call with SEC Investor Advisory Committee Members (Feb. 6, 2019) ("I hope market participants will continue to submit . . . ideas to the comment file for the November proxy roundtable."), https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-call-020619.

[43] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Brent J. Fields Secretary, Securities and Exchange Commission (Jan. 31, 2019) [hereinafter January Letter], https://www.cii.org/files/20190131%20CII%20Follow%20Up%20Letter%20to%20SEC%20on%20Proxy%20Mechanics%20FINAL.pdf.

[44] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Brent J. Fields Secretary, Securities and Exchange Commission (Nov. 8, 2019) [hereinafter November Letter], https://www.cii.org/files/20181108%20CII%20Letter%20for%20SEC%20Proxy%20Roundtable.pdf.

[45] Chairman Jay Clayton, Remarks for Telephone Call with SEC Investor Advisory Committee Members.

Authorizing and Applying Technology to Modernize the Proxy System

CII has encouraged the SEC to take the lead on meaningfully modernizing the proxy voting infrastructure, which we believe will likely require changes at a more fundamental level with respect to share ownership and clearance.[46] The current system, built over decades and composed of layers of intermediaries, is antiquated.

Technological change now offers the opportunity to construct a better system of share ownership based on traceable shares, with the potential to fix a panoply of problems associated with proxy voting. We have proposed private, permissioned blockchains as one technology the SEC should consider.[47]

We recognize that "blockchain" has become a buzzword and that it cannot solve every problem present in the financial system. But share ownership is an area where the technology matches the use cases particularly well, presenting an opportunity to improve investors' experience with share ownership and voting.

We believe that pursuing the promising pathway of a blockchain solution enabling traceable shares will require the SEC to offer regulatory relief from the current system of share immobilization and national clearance and settlement established over decades of regulation. To be clear, that relief entails setting regulatory standards that issuers and their agents must meet in order to take advantage of the regulatory relief.

Since Roundtable, CII has met with firms developing blockchain-based solutions to share ownership and voting. These innovators are waiting at the gates of the public capital markets, eager to enter but obstructed by outdated regulations. We believe the SEC should work directly with private sector innovators, alongside issuers willing to adopt these technologies, to develop case-by-case regulatory relief, which may include individual guidance, no-action letters, and/or exemptive orders. Accordingly, we have recommended that the SEC initiate a formal comment process with respect to potential blockchain-related rulemaking.

Interim Improvements

CII is committed to working with Commissioner Roisman, the SEC, and other market participants to assist in the development of block-chain related rulemaking. As with any rulemaking, our approach to modernizing the proxy system may, at a minimum, take months to put in place. In the interim, there are two areas in which the SEC should be able to relatively quickly improve the current proxy system: vote confirmation and universal proxy.

1. *Vote Confirmation*

---

[46] November Letter, *supra* note 44, at 3 n.7 ("in the past, [CII has] . . . favored an approach of incremental improvement over ambitious, systemic change . . . [But] . . . [w]e believe the current moment is different — that technological innovation makes it worthwhile now to consider fundamental reform, even while we make continued efforts at short-term improvements to the present system.").

[47] *Id.* at 8 ("We believe that a reconceptualization of the system should look first to key principles, and remain open to various alternatives . . . our sense now is that an approach based on a private, permissioned blockchain . . . may prove to be the best approach, and should receive substantial attention.").

We believe investors should be provided end-to-end vote confirmation, and to fulfill that objective, early reconciliation of vote entitlements.[48] The SEC possesses the authority to facilitate these solutions, largely based on the Form 8-K requirement for accurate and complete disclosures. The SEC could require early reconciliation of vote entitlements as necessary for accurate Form 8-K vote disclosure.

Industry pilots conducted by Broadridge and transfer agents in 2014 and 2015 validated the steps required to facilitate vote confirmation, including steps involving early validation of vote entitlements. Broadridge has described to us these specific steps, and we believe the SEC should issue guidance to implement them.

Pre-reconciliation will eliminate many of the inefficiencies and anomalies described in the current system. More fundamentally, end-to-end vote confirmation provides beneficial owners—those with the right to vote—the assurance that their votes are counted and the ability to correct any errors.

2. *Universal Proxy*

We agree with the "many panelists" at the Roundtable who recommended that the SEC finalize its 2016 proposal on universal proxy.[49] In a December 13, 2018, comment letter submitted in response to the SEC's regulatory agenda, we addressed what we view as unconvincing criticisms of the universal proxy proposal raised by a few of the Roundtable panelists.[50] These criticisms focused on formatting issues in designing a universal proxy card, but the SEC's proposal, in our view, already fully and appropriately addresses these issues. In our letter, we cited the proposal's formatting requirements, which include distinguishing between company and dissident nominees, listing nominees alphabetically in each group, using uniform font styles and sizes, and disclosing the maximum number of electable nominees, among other specifications.[51]

CII continues to believe that the SEC should promptly adopt a final rule largely consistent with its 2016 proposal on universal proxy.[52] A universal proxy will help fix enduring issues affecting the

---

[48] *See, e.g.,* Letter from Marcie Frost, Chief Executive Officer, California Public Employees' Retirement System 3 (Dec. 11, 2018) ("To the extent that there are technological solutions that would better promote end-to-end vote confirmation, we think that those efficient solutions should be pursued to support greater vote certainty."), https://www.sec.gov/comments/4-725/4725-4765670-176812.pdf.

[49] Adé Heyliger et al., Key Takeaways from the SEC's Proxy Process Roundtable: Is Proxy Voting Reform on the Horizon?, Weil, Gotshal & Manges LLP 2 (Nov. 20, 2018), https://www.jdsupra.com/legalnews/key-takeaways-from-the-sec-s-proxy-45650/.

[50] *See* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 3-4 (Dec. 13, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/December%2013%202018%20SEC%20Reg%20Flex%20Letter.pdf.

[51] *Id.*

[52] *See* Letter from Ken Bertsch, Executive Director, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 3 (Dec. 28, 2017) (providing extensive comments in response to the 2016 proposal and noting that "[w]ith minor enhancements, the proposed framework will provide for a constructive universal proxy regime that gives greater effect to existing shareholder rights"), https://www.cii.org/files/issues_and_advocacy/correspondence/2016/12_28_16_comment_letter_SEC_universal_pr

most contested and consequential votes, and allowing investors to split their tickets in proxy contests serves the principle that shareholders voting by proxy should have the same voting privileges as those voting in person.[53]

Shareholder Proposals and Proxy Advisors

In a December 5, 2018, letter to the Committee ahead of its December 6, 2018, hearing on the proxy process, we provided detailed comments on the appropriateness of the current shareholder proposal rule and regulations pertaining to proxy advisory firms.[54] On shareholder proposals, we noted that: "We generally share the reported view of certain SEC staff members that left the roundtable with the impression that stronger arguments were made in favor of keeping the current Rule 14a–8 eligibility requirements and resubmission thresholds."[55]

While we recognize that the existing ownership and resubmission thresholds were set long ago, we believe the current shareholder proposal rules permit investors to express their voices collectively on issues of concern to them, without the cost and disruption of waging proxy contests.[56] And we believe the rule works particularly well in granting retail investors—who lack other avenues to meaningfully engage with management—a voice in the companies they own.

As Michael Garland, Assistant Comptroller, for Corporate Governance and Responsible Investment, in the Office of New York City Comptroller Scott Stringer, testified before the Committee in December:

> All shareowners regardless of their ownership stake, should have the opportunity to fully exercise the rights of share ownership, casting proxy votes consistent with their investment preferences and objectives, **and** submitting shareowner proposals.[57]

---

oxy.pdf; November Letter, supra note 44, at 8-10 (addressing recent substantive concerns about universal proxy); *see also* Letter from Marcie Frost at 2 ("we ask the SEC to . . . adopt a mandatory universal proxy card").

[53] *See, e.g.,* Letter from Marcie Frost at 2 ("We have long supported a proxy voting system that works without the need of physical presence to vote for the full slate of director candidates and the current proxy voting process does not provide shareowners with an efficient and cost-effective way to exercise this right.").

[54] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Michael Crapo, Chairman, Senate Committee on Banking, Housing, and Urban Affairs et al. 1-8 (Dec. 5, 2018) [hereinafter December Letter], https://www.cii.org/files/issues_and_advocacy/correspondence/2018/December%205%202018%20Letter%20to%20Senate%20Banking.pdf.

[55] *Id.* at 8 (internal quotations omitted).

[56] *See id.* 5-6 (citing specific improvements in U.S. corporate governance practices that would not have occurred absent a robust shareowner proposal process); *see also* Letter from Marcie Frost at 2 ("Increasing the thresholds will reduce company and shareholder engagement, thus exacerbating an existing weakness in our system given that there is relatively little company engagement with shareowners."); Proxy Process and Rules: Examining Current Practices and Potential Changes: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs, 115th Cong. (Dec. 6, 2018) (Statement of Michael Garland, Assistant Comptroller, for Corporate Governance and Responsible Investment, in the Office of New York City Comptroller Scott Stringer), https://www.banking.senate.gov/imo/media/doc/Garland%20Testimony%2012-6-18.pdf.

[57] Statement of Michael Garland at 12.

On proxy advisory firms, we highlighted in our letter that: "Notably, at the end of the Roundtable when the SEC staff asked if proxy advisory firms need additional regulation, no panelist—including those speaking on behalf of the corporate community . . . —voiced any need for new regulations."[58] One of those panelists was Patti Brammer, Corporate Governance Officer, Ohio Public Employees Retirement System (OPERS). Consistent with her comments at the Roundtable, a recent follow-up letter to the SEC explained:

> *OPERS does not believe additional regulation of proxy advisory firms is warranted.* If however, the SEC believes that some intervention is necessary, we urge the Commission to carefully consider the consequences of any potential changes, particularly for the investors that depend on the information provided by proxy advisory firms. To the extent that a regulatory change increases our costs, delays the information we need, or erodes the confidence we have in the independence of the research reports we receive, there will be a negative impact on our members – the law enforcement officers, university employees, librarians, road workers, and others who depend on us for their retirement security. We respectfully request that the SEC preserve our access to efficient, timely, and independent information from our proxy advisory firm.[59]

Similarly, in a post-Roundtable letter to the SEC, T. Rowe Price Associates, Inc. stated: "We . . . would have significant concerns with any regulatory changes that would sacrifice the objectivity of proxy advisor reports or introduce delays in the proxy voting process that, in an already compressed and intensely seasonal voting cycle, could result in missed vote deadlines."[60]

We note that some Roundtable participants raised concerns regarding conflicts of interest, factual errors, and overly standardized voting guidelines. While we concede that there is room for improvement, SEC Staff Legal Bulletin No. 20, in our estimation, already effectively requires investment advisors to ensure that voting recommendations are based on current and accurate information and to identify and address conflicts of interest.[61] Like OPERS, T. Rowe Price, and many market participants, we do not see additional regulation or legislation of proxy advisors as necessary or beneficial to capital formation or corporate governance.[62]

---

[58] December Letter, *supra* note 54, at 3-4.

[59] Letter from Karen Carraher, Executive Director, Ohio Public Employees Retirement System et al. to Brent J. Fields, Secretary, Securities and Exchange Commission 4 (Dec. 13, 2018), https://www.sec.gov/comments/4-725/4725-4767821-176841.pdf.

[60] Letter from Donna F. Anderson, Head of Corporate Governance, T. Rowe Price Associates, Inc. et al. to Brent J. Fields, Esq., Secretary, Securities and Exchange Commission 3 (Dec. 13, 2018), https://www.sec.gov/comments/4-725/4-725.htm.

[61] *See, e.g.,* January Letter, *supra* note 43, at 10.

[62] *See* Letter from Marcie Frost at 2 ("we do not support an unduly burdensome regulatory regime for proxy advisory firms that would unnecessarily increase costs and reduce efficiency in exercising our proxy votes"); Statement of Assistant Comptroller Michael Garland of the Office of the New York City Comptroller at 3 ("With respect to proxy advisory firms, we oppose any additional . . .SEC[] actions that would compromise the independence of research, reduce the amount of time we have to review research aimed at voting at that company's annual meeting, or that would otherwise impose additional costs on our participants and beneficiaries in terms of either added burdens on our staff resources or additional compliance costs imposed on our advisors, which we, as paying clients, would ultimately bear.").

****

If we can answer any questions or provide additional information that would be helpful to you or the Committee, please do not hesitate to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,

Jeffrey P. Mahoney
General Counsel