

Via Hand Delivery

May 14, 2019

The Honorable Carolyn B. Maloney
Chair
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: May 15, 2019 Hearing entitled: “Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers”¹

Dear Madam Chair and Ranking Member Huizenga:

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 two legislative proposals on corporate governance related topics that are of great interest to our members and that are expected to be discussed at your May 15, 2019 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, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers (May 15, 2019), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403651>.

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>.

Human Capital Management (HCM)

*CII generally supports H.R. ____, To amend the Securities and Exchange Act of 1934 to require issuers to disclose information about human capital management in annual reports (HCM Bill).*³

CII believes that institutional and retail investors have a pronounced interest in clear and comparable information about how public companies approach HCM.⁴ That interest is supported by the growing body of research that has found that high quality HCM practices correlate with better corporate performance.⁵

Human capital is an increasingly important value driver for companies, including those with securities listed on U.S. exchanges. We would note in this regard that the “ESG” label, in and of itself, may cause confusion to the extent disclosure on human capital as a value driver and source of risk is placed within that category.

CII has a broad tent of members, some more enthusiastic on the language of “ESG” than others, but we are unaware of any segment of our membership that does not consider human capital as important to valuation of most companies, and critical in particular for certain growth sectors.⁶

³ H.R. ____, To amend the Securities Exchange Act of 1934 to require issuers to disclose information about human capital management in annual reports, 116th Cong. (2019) (DRAFT), <https://financialservices.house.gov/uploadedfiles/bills-116pih-humancapital.pdf> [hereinafter HCM Bill].

⁴ Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Michael D. Crapo, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate et al. 2 (Apr. 8, 2019), [https://www.cii.org/files/April%208%202019%20%20Letter%20to%20Senate%20Banking%20Committee%20KB.docx%20\(finalIII\).pdf](https://www.cii.org/files/April%208%202019%20%20Letter%20to%20Senate%20Banking%20Committee%20KB.docx%20(finalIII).pdf) [hereinafter April Letter]; see Recommendation from the Investor-as-Owner Subcommittee on Human Capital Management Disclosure, Investor Advisory Committee 2 (approved Mar. 28, 2019), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac032819-investor-as-owner-subcommittee-recommendation.pdf> (“Institutional and retail investors have a pronounced interest in clear and comparable information about how firms approach HCM”); see also Chairman Jay Clayton, Remarks for Telephone Call with SEC Investor Advisory Committee Members (Feb. 6, 2019), <https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-call-020619> (“for human capital, I believe it is important that the metrics allow for period to period comparability for the company”).

⁵ See Mike Krings, Business Professor Examines Why Firms Don’t Use Human Capital Data, UK, Apr. 30, 2019, <https://news.ku.edu/2019/04/17/business-prof-examines-why-firms-dont-use-human-capital-data-recommends-steps-improve> (“Firms that have low turnover rates, high employee satisfaction and other measures of workforce excellence often have an advantage over their competitors.”); Letter from Dr. Anthony Hesketh, Department of Organization, Work & Technology, Lancaster University Management School to Anne Sheehan, Chairman Investor Advisory Committee, U.S. Securities and Exchange Commission 4 (Mar. 21, 2019), <https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf> (summarizing recent research and including relevant citations suggesting “the depth of human capital disclosure is highly associated with high performance”); Mark Huselid, The Impact of Human Resource Management Practices on Turnover, Productivity, and Corporate Financial Performance, 18 Acad. of Mgmt J. 635 (1995), http://www.markhuselid.com/pdfs/articles/1995_AMJ_HPWS_Paper.pdf (indicating that certain human capital management practices “have an economically and statistically significant impact on . . . long-term measures of corporate financial performance”).

⁶ We are concerned that some market participants appear to be seeking to limit certain material disclosures by labeling the matters as “ESG.” In our view, materiality is materiality. Political efforts to constrain disclosure by slapping the “ESG” label on particular areas and essentially saying these are “no-go” subjects are profoundly misguided. We presume that within the human capital context, those opposed to improving disclosure may be thinking in part of risk areas such as challenges in employee recruitment deriving from discriminatory employment policies or prevalence of sexual harassment. We view these matters as clearly material. To take the latter subject, as

And historically, corporate disclosures on human capital have been limited, in part because of the importance of intangible factors not easily quantified.

We believe that the time has come to seek ways to improve disclosure of both qualitative and quantitative elements of performance in this area.⁷ Employee turnover is an example of a measurable, comparable statistic that should be considered as a key disclosure at most or all public companies.⁸

We generally support the recent recommendations of the Investor-as-Owner Subcommittee of the Securities and Exchange Commission (SEC or Commission) Investor Advisory Committee that “as part of its ongoing disclosure review, the Commission . . . undertake a robust examination of the role HCM plays in value creation today and incorporate that analysis into the wide range of tasks the Commission performs on behalf of investors and the US capital markets.”⁹ As part of this, and without diminishing the need for comparable metrics, we also suggest that the SEC’s Division of Corporation Finance consider whether further guidance on company disclosures in Management Discussion and Analysis should be provided to encourage management to do a better job of disclosing to shareholders management’s thinking and strategy on human capital development and risks.¹⁰

HCM Bill

The provisions of the HCM Bill would require all companies that issue an annual report under Section 13 of the Securities Exchange Act of 1934¹¹ to include specified information about the company’s “human capital management policies, practices, and performance.”¹² The HCM Bill includes nine specific items recommended in a pending rulemaking petition by the Human Capital Management Coalition,¹³ a group that includes a number of CII members.¹⁴ At the time the petition was issued, we commented that “CII believes that the [petition] . . . provides the . . .

CII discussed in a 2018 report, allegations of sexual harassment have had serious repercussions for value at a number of companies, with negative impacts on shareholders. *See* CII, *How Corporate Boards Can Combat Sexual Harassment, Recommendations and Resources for Directors and Investors 2* (March 2018),

https://www.cii.org/files/publications/misc/03_01_18_corporate_boards_sexual_harassment.pdf (“Allegations of sexual harassment and mishandling those allegations can clearly affect the value of a company.”).

⁷ April Letter, *supra* note 4, at 3; *see* Mike Krings (“Both the investment and regulation communities should explore the standardization of human capital information”).

⁸ *See* Mike Krings (“Those who demonstrate . . . low turnover rates . . . would do well to share that information); Recommendation from the Investor-as-Owner Subcommittee on Human Capital Management Disclosure at 4 (listing “company selected but standardized human capital related key performance indicators (KPIs), such as: [] the stability of the workforce, including voluntary and involuntary turnover”).

⁹ Recommendation from the Investor-as-Owner Subcommittee on Human Capital Management Disclosure at 5.

¹⁰ April Letter, *supra* note 4, at 3.

¹¹ Periodical and Other Reports, 15 U.S. Code § 78m (amended Dec. 4, 2015), *available at* <https://www.law.cornell.edu/uscode/text/15/78m>.

¹² HCM Bill, *supra* note 3, § 2(s)(2)(A)-(I).

¹³ Letter from Meredith Miller, Chief Corporate Governance Officer, UAW Retiree Medical Benefits Trusts to William Hinman, Director, Division of Corporate Finance, Brent J. Fields, Secretary, Securities and Exchange Commission 26 (July 6, 2017), <https://www.sec.gov/rules/petitions/2017/petn4-711.pdf>.

¹⁴ UAW Retiree Medical Benefits Trusts, Human Capital Management Coalition, Members List, <http://www.uawtrust.org/AdminCenter/Library.Files/Media/501/About%20Us/HCMCoalition/hcmmembership2018.pdf>.

Commission . . . with a thoughtful resource for further exploration of the need for enhancements to HCM disclosures.”¹⁵

As indicated, we believe there are alternatives to legislation as a means for achieving improvements to public company disclosure of HCM. We, however, note that the HCM Bill provides for SEC rulemaking,¹⁶ which is one possible solution.¹⁷

As you know, the SEC has a thorough and public due process that provides investors and all market participants the opportunity to provide input to the Commission in response to a proposed rule. In that regard, we would support the following revisions to the HCM Bill that we believe would better ensure that a SEC final rule meets the needs of investors: (1) replace the proposed time period in which the SEC is required to issue “final rules” from “120 days after the date of enactment” to a more reasonable “360 days after the date of enactment;”¹⁸ (2) replace the proposed requirement that the “final rules shall require disclosure” of the nine specific items with a requirement that the Commission “shall consider whether the final rules shall require disclosure” of the nine items;¹⁹ and (3) clarify that the SEC shall consider whether the final rules should include qualitative disclosures that provide issuers the opportunity to explain and comment on required quantitative metrics.

Stock Buybacks

*CII generally supports H.R. ____, To require the Securities and Exchange Commission to study whether to amend the rules of the Commission relating to certain stock repurchases, and for other purposes (Buyback Bill).*²⁰

Public companies are always looking for ways to invest profits to increase their future growth. At some point, they may run out of investment opportunities with enough growth potential to justify an investment. In those cases, companies may decide to use their profits in another way, to buy back shares of the company or to grant dividends.

CII believes that stock buyback decisions are, at their core, capital allocation decisions²¹ and making it harder for companies to pursue stock buybacks could force them to sit on cash or

¹⁵ Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Jay Clayton, Chairman, Securities and Exchange Commission 1 (Oct. 10, 2017), https://www.cii.org/files/issues_and_advocacy/correspondence/2017/10-6-17%20CII%20letter%20to%20SEC%20on%20HCM.pdf.

¹⁶ HCM Bill, *supra* note 3, § 2(s)(2).

¹⁷ Recommendation from the Investor-as-Owner Subcommittee on Human Capital Management Disclosure at 3 (indicating “rule-making” as possible approach to addressing the issue).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ H.R. ____, To require the Securities and Exchange Commission to study whether to amend the rules of the Commission relating to certain stock repurchases, and for other purposes, 116th Cong. (2019) (DRAFT), <https://financialservices.house.gov/uploadedfiles/bills-116pih-buybacks.pdf> [hereinafter Buyback Bill].

²¹ Council of Institutional Investors, Corporate Governance Policies § 5.9b Stock Repurchase Programs (updated Oct. 28, 2018), https://www.cii.org/files/10_24_18_corp_gov_policies.pdf (“Stock buyback decisions are a capital allocation decision”).

waste it on projects with a low potential for success.²² This may not be the wisest use of a company's profits, as it can hurt growth and erode investor confidence.

Moreover, the money spent on buybacks does not evaporate; it is often invested by shareowners in other companies that need capital more than the company executing the buyback. That reinvestment in a higher use creates a benefit that inures to investors and to society more broadly.²³

CII does not believe that all stock buybacks are appropriate.²⁴ For example, we believe that companies should not repurchase their shares to boost the stock in the short term—especially if CEO pay is linked to earnings per share or measures of capital efficiency, such as return on equity or return on assets, which are also lifted when equity is reduced.²⁵ That is why we advocate for strong corporate governance practices at public companies “guiding how the decisions about stock buybacks . . . are made, to ensure they are made with the long-term interests in mind.”²⁶

More specifically, CII believes the board of directors should discuss in the company's proxy statement its review and approval process for share repurchase programs with creating long-term value.²⁷ We also believe management should disclose how stock buybacks affect performance metrics, perhaps in a table showing how the company would have performed absent a change in the number of shares outstanding.²⁸

Buyback Bill

The provisions of the Buyback Bill would require the SEC to conduct a study of whether Rule 10b-18, the “safe harbor” share buyback rule,²⁹ should be amended in a number of ways, including:

- limits on the ability of a company “to announce or implement a stock repurchase plan at [the company] does not intend to fulfill;”³⁰

²² Joshua Bolton & Ken Bertsch, Opinion, Restricting Stock Buybacks Will Hurt the Economy, N.Y. Times, Mar. 4, 2019, <https://www.nytimes.com/2019/03/04/opinion/sanders-stock-buybacks.html> (“Making it harder for companies to do [stock buybacks] . . . could force them to sit on cash or waste it on projects with a low potential for success”).

²³ Commissioner Hester M. Peirce, Speech, Festivus, Fortnite, and Focus: Remarks before the Council of Institutional Investors Spring Conference (Mar. 5, 2019), <https://www.sec.gov/news/speech/speech-peirce-030519>.

²⁴ Council of Institutional Investors, CII Statement on Share Buybacks (Feb. 5, 2019), <https://www.cii.org/feb5sharebuybacks> (“Some buybacks are not appropriate”); see Council of Institutional Investors, Corporate Governance Policies § 5.9b Stock Repurchase Programs (“Stock buyback decisions . . . should not be driven solely for the purpose of minimizing dilution from equity-based compensation plans.”).

²⁵ Council of Institutional Investors, CII Statement on Share Buybacks.

²⁶ Joshua Bolton & Ken Bertsch.

²⁷ Council of Institutional Investors, CII Statement on Share Buybacks; see Council of Institutional Investors, Corporate Governance Policies § 5.9b Stock Repurchase Programs (“The compensation committee should provide information about stock repurchase programs and the extent to which such programs are used to minimize the dilution of equity-based compensation plans.”).

²⁸ Council of Institutional Investors, CII Statement on Share Buybacks.

²⁹ Purchase of Certain Equity Securities by the Issuer and Others, 17 C.F.R. § 240.10b-18 (amended June 29, 2005), available at <https://www.law.cornell.edu/cfr/text/17/240.10b-18>.

³⁰ Buyback Bill, *supra* note 20, § 2(b)(1)(A).

- limits on the ability of a company to announce a new buyback plan if during the prior 12 months the company has not fulfilled a prior buyback plan;³¹ and
- disclosure at the time of announcement of the minimum number or dollar amount of shares to be repurchased and the time frame;³² “timely” disclosures as to each buyback;³³ set a period of time after an announcement within which a director or officer may not sell stock or exercise an option;³⁴ and an accounting of any significant changes in the period after Rule 10b-18 and prior to adoption in terms of how companies, officers and directors use stock buyback plans.³⁵

The Buyback Bill would also require the SEC to report the results of its study to Congress and, within one-year of such report, to amend its rules to address the results of the report.³⁶

CII understands and appreciates many of the concerns that have been raised about stock buybacks and Rule 10b-18.³⁷ We, however, believe the scope of the study contained in the Buyback Bill should not be limited to a Rule 10b-18 framework.

In our view, the provisions of the Buyback Bill should be broadened to include a more comprehensive study how the SEC might improve public company management *and* board disclosures of stock buybacks to better meet the information needs of investors. For example, the study might include what the SEC has learned and potential improvements to stock buyback disclosures in response to its 2016 Concept Release on “Business and Financial Disclosure Required by Regulation S-K” (2016 Release).³⁸

The 2016 Release sought input on a number of questions regarding frequency and granularity of the tabular disclosures of equity purchases required by Item 703 of Regulation S-K.³⁹ One question in particular that we believe should be given further consideration is whether the SEC should require Form 8-K disclosure of stock buybacks that exceed a certain threshold.⁴⁰

³¹ See *id.* § 2(b)(1)(B).

³² See *id.* § 2(b)(1)(C)(i).

³³ See *id.* § 2(b)(1)(D).

³⁴ See *id.* § 2(b)(1)(E).

³⁵ See *id.* § 2(b)(1)(F).

³⁶ See *id.* § 2(c)-(d).

³⁷ See, e.g., Commissioner Robert J. Jackson Jr., Speech, Stock Buybacks and Corporate Cashouts (June 11, 2018), <https://www.sec.gov/news/speech/speech-jackson-061118> (discussing the history of Rule 10b-18 and explaining why the “rules should be updated.”).

³⁸ Business and Financial Disclosure Required by Regulation S-K, Securities Act Release 10,064, Exchange Act Release 77,599 (concept release Apr. 13, 2016), <https://www.sec.gov/rules/concept/2016/33-10064.pdf>.

³⁹ *Id.* at 193-94.

⁴⁰ *Id.* at 194 (“For example, should we require Form 8-K disclosure only of repurchases that exceed a certain threshold, similar to Item 3.02 of Form 8-K, which requires registrants to disclose sales of equity securities that constitute more than one percent of the shares outstanding of the class of equity securities?”); cf. Jesse M. Fried, Insider Trading Via The Corporation, 162 U. Pa. L. Rev. 801, 839 (2014), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=7689&context=penn_law_review (concluding that “[p]ublicly held U.S. firms trading their own shares [should, like insiders, be required to] . . . report the specific details of each trade within two business days”).

Page 7 of 7
May 14, 2019

Improvements in the requirements of Item 703 of Regulation S-K and Form 8-K, perhaps combined with better disclosure about public company boards' review and approval processes for stock buyback programs, could assist investors in better understanding the relationship between stock buybacks, executive compensation, and capital allocation decisions.

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

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeffrey P. Mahoney
General Counsel