

Attachment

Via E-Mail

April 22, 2021

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. S7-14-20

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII). CII is a nonprofit, nonpartisan association of United States (U.S.) 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, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.¹

This letter is in response to the Securities and Exchange Commission’s (SEC or Commission) invitation to comment on its semiannual regulatory agenda (Agenda).² CII recognizes that the Agenda reflects the priorities of the former SEC Chairman Jay Clayton³ and we are optimistic that under new leadership future agenda’s will align with the needs and demands of long-term investors and our capital markets generally.

CII’s current SEC rulemaking priorities fall into the following three categories: (1) Investor Rights and Protections; (2) Corporate Disclosure; and (3) Markets Systems & Structure.⁴

¹ 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>.

² Regulatory Flexibility Agenda, Securities Act Release No. 10,873, Exchange Act Release No. 91,131, Investment Adviser Act Release No. 5,610, Investment Company Act Release No. 34,047, 86 Fed. Reg. 17,040 (Oct. 8, 2020), <https://www.federalregister.gov/documents/2021/03/31/2021-04360/regulatory-flexibility-agenda>.

³ See *id.* at 17,040 (“The items listed in the Regulatory Flexibility Agenda for Fall 2020 reflect only the priorities of the Chairman of the U.S. Securities and Exchange Commission, and do not necessarily reflect the view and priorities of any individual Commissioner.”).

⁴ Council of Institutional Investors, CII Advocacy Priorities – 2021 (Apr. 22, 2021), https://www.cii.org/2021_priorities.

1. Investor Rights and Protections

We include under this heading, our support for completed action on “Listing Standards for Recovery of Erroneously Awarded Compensation.”⁵ We are disappointed the Agenda categorizes this regulation within “Long-Term Actions.”⁶

Listing Standards for Recovery of Erroneously Awarded Compensation

As summarized on our website:

CII believes that boards should recover previously paid executive incentive compensation in the event of acts or omissions resulting in fraud, financial restatement or some other cause the board believes warrants recovery, which may include personal misconduct or ethical lapses that cause, or could cause, material reputational harm to the company and its shareholders.

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act [(Dodd-Frank)] directed the SEC to adopt a rule to require claw backs of unearned executive compensation in certain circumstances. In 2015, the SEC proposed a claw back rule that CII believes provides a floor for such policies. But the SEC has not taken final action on the rule proposal.⁷

We generally agree with the following comments contained in an October 2020 letter signed by eight members of the U.S. House of Representatives (House) to then SEC Chairman Clayton:

Unfortunately, despite being called for under Section 954 of the Dodd-Frank Act more than 10 years ago, and despite a proposed rule being issued more than five years ago, these rules have not only not been finalized, this required rulemaking was removed from the SEC’s priority rulemaking agenda at the beginning of this administration. . . . That lack of action and attention at the SEC is extremely disappointing.

The SEC proposed a rule to address this problem in June of 2015, which would have required all listed companies to have a policy requiring clawbacks from executive officers. . . .

. . . This type of common-sense policy should never have been delayed this long, and a strong rule to protect investors should be finalized quickly. We urge your swift attention to this matter⁸

⁵ See CII Advocacy Priorities – 2021, Investor Rights & Protections (Apr. 22, 2021), https://www.cii.org/investor_rights_protections.

⁶ See 86 Fed. Reg. at 17,041, 17,043.

⁷ See CII Advocacy Priorities – 2021, Investor Rights & Protections.

⁸ Letter from Cynthia Axne, Members of Congress et al. to The Honorable Jay Clayton, Chairman, Securities and Exchange Commission (Oct. 6, 2020), <https://axne.house.gov/sites/axne.house.gov/files/10.6.20%20Axne-Sherman%20Letter%20to%20SEC%20on%20Valeant%20and%20Clawbacks.pdf>.

CII acknowledges the observation of SEC Chairman Clayton that “several companies . . . [have clawback] policies [that] go beyond what would be required under Dodd-Frank.”⁹ And that clawbacks for causes other than Dodd-Frank’s accounting restatements are supported by CII’s policies¹⁰ and the policies of some of our members.¹¹ We, however, note that despite the requirements of Dodd-Frank, some companies’ clawback policies for restatements continue to require proof of misconduct¹² and at some public companies clawback policies do not yet exist.¹³

⁹ U.S. Securities and Exchange Commission, Chairman Jay Clayton, Testimony on “Oversight of the U.S. Securities and Exchange Commission,” Before the Comm. on Fin. Servs., U.S. H.R. at n.50 (June 21, 2018), <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission>; see Joshua A. Agen, of Counsel, Foley & Lardner LLP, Compensation Clawbacks: Trends and Lessons Learned, Emp. Benefit Insights (Oct. 21, 2020), <https://www.foley.com/en/insights/publications/2020/10/compensation-clawbacks-trends-and-lessons-learned> (“there has been a notable trend in these voluntarily-adopted compensation clawback policies to broaden them to apply in more circumstances and cover additional types of compensation and conduct”); Lane Ringlee & John Ellerman, Recent SEC Action – Clawbacks and Proxy Advisory Firm Regulations (Aug. 12, 2020), <https://www.paygovernance.com/viewpoints/recent-sec-actions-clawbacks-and-proxy-advisory-firm-regulations> (“many clawback policies adopted by companies over the past several years cover a broader group of executives and include trigger events that are more expansive than the proposed rules”); Jonathan Ocker et al., The State of Play on Clawbacks and Forfeitures Based on Misconduct, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (July 7, 2019), <https://corpgov.law.harvard.edu/2019/07/07/the-state-of-play-on-clawbacks-and-forfeitures-based-on-misconduct/> (“While many companies are adopting or modifying their existing clawback policies in a manner intended to meet the proposed Dodd-Frank clawback rules, some companies also go beyond these minimum requirements and include additional clawback triggers in their clawback policies and forfeiture provisions, such as detrimental behavior and violation of restrictive covenants”); 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 Corp. Governance and Responsible Inv., In the Office of the N.Y.C. Comptroller Scott Stringer at 8), <https://www.banking.senate.gov/imo/media/doc/Garland%20Testimony%202012-6-18.pdf> (indicating that the successful negotiation of a broad clawback policy at Wells Fargo “enabled the Wells Fargo Board of directors to announce in September 2016 that it would recoup \$60 million from two senior executives in order to hold them financially accountable for the fake account scandal that involved the loss of jobs by 5,300 lower-level employees and cost Wells Fargo \$185 million in fines and penalties”); Kathryn Neel et al., The Business Case for Clawbacks, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (May 6, 2018), <https://corpgov.law.harvard.edu/2018/05/06/the-business-case-for-clawbacks/> (listing Cognizant Technology Solutions, Wells Fargo, Zions Bancorp, and EBay as companies that have adopted “detrimental conduct” clawback policies).

¹⁰ See Council of Institutional Investors, Corporate Governance Policies, § 5.7 Compensation Recovery (updated Sept. 22, 2020), https://www.cii.org/files/policies/09_22_20_corp_gov_policies.pdf (“Clawback policies should ensure that boards can refuse to pay and/or recover previously paid executive incentive compensation in the event of acts or omissions resulting in fraud, financial restatement or some other cause the board believes warrants recovery, which may include personal misconduct or ethical lapses that cause, or could cause, material reputational harm to the company and its shareholders [and] [c]ompanies should disclose such policies and decisions to invoke their application.”).

¹¹ See Joshua A. Agen, of Counsel, Foley & Lardner LLP, Compensation Clawbacks: Trends and Lessons Learned, Emp. Benefit Insights (referencing the clawback policies of “BlackRock” and “CalPERS”).

¹² See Press Release, Retiree Proxies to Limit Golden Parachutes, Strengthen Clawback Policy at Verizon, Yahoo!Finance (Apr. 5, 2021), <https://finance.yahoo.com/news/retiree-proxies-limit-golden-parachutes-144900921.html> (discusses shareholder proposal to eliminate “willfull misconduct” language from clawback policy because “[t]he issue of ‘willful misconduct’ ascribes a motive to any such actions, which is very easy to challenge but very difficult to prove”).

¹³ Jonathan Ocker et al., The State of Play on Clawbacks and Forfeitures Based on Misconduct, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (noting the “absence of clawbacks at Alphabet and Facebook “); cf. Joshua A. Agen, of Counsel, Foley & Lardner LLP, Compensation Clawbacks: Trends and Lessons Learned, Emp. Benefit Insights (“More than 90 of the 100 largest publicly-traded companies have disclosed that they maintain compensation clawback policies.”); Carpenter Wellington PLLC, Clawback of Executive Pay Can Reach Past and Future

We believe finalizing the SEC's 2015 proposal would address deficiencies in current practice and improve corporate governance by establishing a minimum standard for clawback policies at listed companies.¹⁴

2. Corporate Disclosure

Included in this category, is CII's support for proposed amendments to the proxy rules to require additional disclosure about the "Diversity of the boards and executive officers."¹⁵ The Agenda categorizes a project on "Corporate Board Diversity" within "Long-Term Actions."¹⁶

Also included in this category is support for Commission action on CII rulemaking petitions to reform and improve disclosure of Rule 10b5-1 trading plans¹⁷ and improve disclosure of the reconciliation to Generally Accepted Accounting Principles (GAAP) of non-GAAP metrics used to determine executive compensation.¹⁸

Compensation, LEXOLOGY (Mar. 8, 2021), <https://www.lexology.com/library/detail.aspx?g=928bdcde-2138-4cec-b201-4e7236fdd0b4#:~:text=Clawback%20of%20Executive%20Pay%20Can%20Reach%20Past%20and%20Future%20C%20ompensation,-Carpenter%20Wellington%20PLLC&text=Executive%20pay%20clawback%20policies%20enable,former%20executives%20under%20certain%20circumstances.&text=Companies%20may%20require%20executives%20to%20reimburse%20prior%20compensation%20or%20forfeit%20future%20payments> (A 2017 study found that over 92% of S&P 500 companies publicly disclosed a clawback policy.”).

¹⁴ We note that some public companies have adopted clawback policies that contain provisions generally consistent with the 2015 Securities and Exchange Commission proposal and whose policies are viewed favorably by some CII members. Those companies include: Lincoln Electric Holdings, Inc., Schedule 14A at 61 (Mar. 19, 2021), <https://www.sec.gov/Archives/edgar/data/59527/000117120021000116/0001171200-21-000116-index.htm>; J.B. Hunt Transport Services, Inc., Schedule 14A at 47 (Mar. 18, 2021), <https://www.sec.gov/Archives/edgar/data/728535/000143774921006495/0001437749-21-006495-index.htm>; Domino's Pizza, Inc., Schedule 14A at 43 (Mar. 18, 2021), <https://www.sec.gov/Archives/edgar/data/1286681/000119312521084940/0001193125-21-084940-index.htm>; Equifax Inc., Schedule 14A at 55-56 (Mar. 25, 2021), https://www.sec.gov/Archives/edgar/data/33185/000130817921000102/1efx2021_def14a.htm; Microsoft Corporation, Executive Compensation Policy (updated July 1, 2017), <https://view.officeapps.live.com/op/view.aspx?src=https://c.s-microsoft.com/en-us/CMSFiles/Executive%20Compensation%20Recovery%20Policy.docx?version=0685b846-89dd-eef2-bc22-dca3407e96ca>.

¹⁵ See CII Advocacy Priorities – 2021, Corporate Disclosure (Apr. 22, 2021), https://www.cii.org/corporate_disclosure.

¹⁶ See 86 Fed. Reg. at 17,041, 17,043.

¹⁷ 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%2010b5-1_trading_plans.pdf.

¹⁸ See Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission 1 (Apr. 29, 2019), https://www.cii.org/Files/issues_and_advocacy/correspondence/2019/20190426%20CII%20Petition%20revised%20on%20non-GAAP%20financials%20in%20proxy%20statement%20CDAs.pdf.

Corporate Board Diversity

As described on our website:

CII generally supports required disclosure of: diversity of . . . boards and executive officers Investors need useful and timely information on company performance and policies relevant to long-term shareholder value. This critical component of capital market efficiency extends to both financial information and “non-financial” information that plausibly can influence long-term financial performance.¹⁹

CII’s membership-approved policy on board diversity reflects the view that corporate governance best practices include the expectation that corporate boards will reflect the diversity of their communities, customers, and employees.²⁰ And that diverse boards can have a significant positive effect on financial performance.²¹ We, however, “believe diverse boards can be achieved without quotas which may result in ‘check-the-box’ diversity.”²²

CII generally supports efforts by the Commission to propose requiring additional disclosure about the diversity of board members and nominees that would improve transparency and comparability of those disclosure across companies.²³ We “believe investors can use the

¹⁹ CII Advocacy Priorities – 2021, Corporate Disclosure.

²⁰ See Council of Institutional Investors, Corporate Governance Policies, § 2.8b Board Diversity.

²¹ See *id.* (“The Council believes a diverse board has benefits that can enhance corporate financial performance, particularly in today’s global market place.”); see also Sonali Basak, Nasdaq, NYSE Diverge on Their Roles in Diversity, Bloomberg Mkt. (Apr. 6, 2021) (on file with CII) (quoting Stacey Cunningham, president of NYSE Group that “[t]he data is very, very clear that businesses perform better when there’s more diversity on their board.”).

²² Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission 3 (Dec. 30, 2020), [https://www.cii.org/Files/December%2030%202020%20Letter%20to%20SEC%20on%20diversity%20proposal%20\(final\)-ABcomments%20LN.v2.pdf](https://www.cii.org/Files/December%2030%202020%20Letter%20to%20SEC%20on%20diversity%20proposal%20(final)-ABcomments%20LN.v2.pdf).

²³ See *id.* (“we believe that [required diversity disclosures could] . . . improve transparency and comparability of disclosure across companies.”); see also Sonali Basak, Nasdaq, NYSE Diverge on Their Roles in Diversity, Bloomberg Mkt. (commenting that “requiring that companies disclose in a standard way whether they have diverse board members to help [investors] make an informed decision”); Lorraine Woellert et al., Shareholders Target ‘World’ with Record Demands for Diversity Data, Politico (Apr. 4, 2021), <https://www.politico.com/news/2021/04/06/shareholders-diversity-data-479159> (“Just half the companies in the S&P 500 index reported anything about corporate board diversity in 2020, according to proxy advisory firm Glass Lewis.”). CII has also long publicly supported legislation to improve disclosure of public company boards. See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Gregory W. Meeks, Chair, Subcommittee on Consumer Protection and Financial Institutions, Committee on Financial Services, United States House of Representatives 1 (Feb. 6, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/February%206%202019%20Representative%20Meeks%20Letter.pdf (“I am writing on behalf of the Council of Institutional Investors . . . to express our strong support for H.R. ___, the “Improving Corporate Governance Through Diversity Act of 2019”); see generally Press Releases, Chairwoman Maxine Waters, Committee Passes Legislation to Advance Racial Equity, Protect Consumers, and Improve Disclosures by Public Companies (Apr. 21, 2021), <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=407679#:~:text=Washington%2C%20DC%2C%20April%2021%2C%202021&text=Today%2C%20the%20House%20Financial%20Services,key%20material%20information%20to%20investors> (CII publicly supporting “[t]he Improving Corporate Governance Through Diversity Act (H.R. 1277), a bill by Representative Gregory Meeks (D-NY), which would require public companies

resulting transparency and comparability to make better-informed investment and voting decisions.”²⁴

While CII believes the Commission should approve the current Nasdaq Stock Market LLCs board diversity proposal,²⁵ we also believe proposing a clear SEC rule on board diversity disclosures could limit disclosure arbitrage and improve transparency and comparability among SEC registrants.²⁶

Rule 10b5-1 trading plans

As described on our website:

Under SEC Rule 10b5-1, executives, directors and other top company insiders are able to establish a written plan that details when they will be able to buy or sell shares at a predetermined time on a scheduled basis. But press reports and empirical research suggest that corporate insiders may have used 10b5-1 trading plans as cover for improper stock trades. Insiders can adopt, amend and cancel these plans easily and without disclosure, a recipe for fortuitously timed trades while in possession of material, non-public information. In 2012, CII submitted a rulemaking petition to the SEC recommending improvements to Rule 10b5-1 and we have urged the commission repeatedly to **close the loopholes** that invite plan abuse.²⁷

In November 2020, in testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Banking Committee), SEC Chairman Clayton informally proposed amending Rule 10b5-1 to require a minimum “cooling-off period” of four to six months, between plan adoption and the first planned trade under a Rule 10b5-1 plan.²⁸

to annually disclose the voluntarily, self-identified gender, race, ethnicity and veteran status of their board directors [and] [t]he bill passed the Committee by a bipartisan voice vote.”).

²⁴ Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 3.

²⁵ See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission 8 (Apr. 1, 2021),

[https://www.cii.org/files/issues_and_advocacy/correspondence/2021/April%201%202021%20Letter%20to%20SEC%20on%20diversity%20proposal%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/April%201%202021%20Letter%20to%20SEC%20on%20diversity%20proposal%20(final).pdf) (“we believe the Amendments should be approved”).

²⁶ See Sonali Basak, Nasdaq, NYSE Diverge on Their Roles in Diversity, Bloomberg Mkt. (“if the government doesn’t step in with clear rules on diversity, there will always be arbitrage.”); see also John Coates & Robert Pozen, FA Center, Opinion: New SEC Chair Needs to Tackle These Big Issues so the Government Can Do a Better Job for Investors, Mkt.Watch (Dec. 17, 2020) (on file with CII) (“the SEC [should] . . . play a meaningful role in the development of consistent disclosures of financially significant topics of diversity and climate risk.”); cf. Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Sherrod Brown, Chairman, Committee on Banking, Housing & Urban Affairs, United States Senate et al. 5-8 (Mar. 18, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/2021%20Investor%20Advocate%20Letter.pdf (supporting draft legislation that would improve corporate governance through enhanced diversity reporting).

²⁷ CII Advocacy Priorities – 2021, Corporate Disclosure.

²⁸ See, e.g., Paul Keiran, Markets, SEC Chairman Urges Corporate Insiders to Avoid Quick Stock Sales, Wall St. J. (Nov. 17, 2020), <https://www.wsj.com/articles/sec-chairman-urges-corporate-insiders-to-avoid-quick-stock-sales-11605637892> (“For senior executive officers using 10b5-1 plans to sell stock, I do believe that a cooling-off period from the time that the plan is put in place or is materially changed, until the first transaction, is appropriate’ . . .

In December 2020, a research paper was published by a Columbia Law School professor indicating that public companies had been disproportionately disclosing positive news about Covid-19 vaccines on days when corporate executives were selling shares under Rule 10b5-1 plans.²⁹ In addition, a study published in January 2021 by the Stanford Graduate School of Business and the Rock Center for Corporate Governance at Stanford University examined over 20,000 10b5-1 plans and found that a subset of executives use the plans to engage in opportunistic large-scale selling of company shares (Stanford Study).³⁰

The Stanford Study contained several policy recommendations, including: (1) Requiring a minimum cooling-off-period of four to six months after plan adoption; (2) Disallowing single-trade plans; (3) Removing the affirmative defense of Rule 10b5-1 for plans that are both adopted and start selling shares before the next earnings announcement; and (4) Improving disclosure of 10b5-1 plans.³¹

In February 2021, three U.S. Senators, including the Chair of the Banking Committee sent a letter to SEC Acting Chair Allison Herren Lee urging a review and reform of SEC policies regarding 10b5-1 plans.³² The letter noted that one day before Pfizer announced the result of the first phase of its clinical trial for the Covid-19 vaccine, the company's CEO modified his Rule 10b5-1 plan and then the next day sold more than 60% of his personal shares in the company, valued at \$5.6 million.³³

The letter requested a response to the following six questions:

1. What actions does the SEC currently take to ensure that 10b5-1 plans are compliant with the Commission's current rules and requirements?
2. How many enforcement actions has the agency taken with regard to 10b5-1 plans in the past five years? Please provide a list and summary of all such actions.

[w]hether that's four months so you cover a full quarter, or it's six months—I can make arguments for either . . . I do think we should do it.”).

²⁹ See Joshua Mitts, Insider Trading and Strategic Disclosure 1 (Dec. 7, 2020) (Colum. L. & Econ. Working Paper No. 636),

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3741464 (“I show that public companies disproportionately disclose positive news on days when corporate executives sell shares under predetermined Rule 10b5-1 plans.”); Insider Trading and Strategic Disclosure with Professor Joshua Mitts, CII (Apr. 7, 2021), <https://www.cii.org/podcasts>.

³⁰ See David F. Larcker et al., Gaming the System: Three “Red Flags” of Potential 10b5-1 Abuse, Stan. Closer Look Series, Corp. Governance Res. Series 1 (Jan. 2021), <https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-88-gaming-the-system.pdf> (“We show that a subset of executives use 10b5-1 plans to engage in opportunistic, large-scale selling of company shares.”); Rule 10b5-1 Trading Plans with Professor Daniel Taylor, CII (Feb. 3, 2021), <https://www.cii.org/podcasts>.

³¹ See David F. Larcker et al., Gaming the System: Three “Red Flags” of Potential 10b5-1 Abuse, Stan. Closer Look Series, Corp. Governance Res. Series at 3 (describing policy recommendations).

³² See Letter from Elizabeth Warren, United States Senator et al. to The Honorable Allison Herren Lee, Acting Chair, Securities and Exchange Commission (Feb. 10, 2021), <https://www.warren.senate.gov/imo/media/doc/02.10.2021%20Letter%20from%20Senators%20Warren,%20Brown,%20and%20Van%20Hollen%20to%20Acting%20Chair%20Lee.pdf>.

³³ *Id.*

3. Has the SEC taken action to require a “cooling off period” between the adoption or amendment of any 10b5-1 plan and any stock sales under that plan?
4. Does the agency intend to require that 10b5-1 plans are disclosed publicly and posted online in advance of any trades made under that plan?
5. Has the SEC considered or evaluated modifications of regulations to ensure that 10b5-1 adequately covers “short-swing” purchases?
6. What other actions has the SEC taken or are under consideration to prevent the abuse of 10b5-1 plans?³⁴

Last month, the Chairwoman of the House Committee on Financial Services reintroduced H.R. 1528, the Promoting Transparent Standards for Corporate Insiders Act (PTS Act).³⁵ The PTS Act, based in part on CII membership approved policies,³⁶ would require the Commission to study and report on possible revisions to limit the ability of issuers of securities and issuer insiders to adopt Rule 10b5-1 trading plans.³⁷

The PTS also requires the SEC to revise the regulations consistent with the results of the study.³⁸ CII publicly supports H.R. 1528 and has informed the staff of the House Committee on Financial Services that we plan to continue to request that the SEC amend Rule 10b5-1 consistent with CII policies.³⁹

Also in March 2021, in an opinion piece published in Bloomberg, co-authors SEC Commissioner Caroline Crenshaw and Professor Daniel Taylor argued that the SEC should reform Rule 10b5-1 plans in several ways: (1) by imposing a mandatory “cooling off period” of four to six months between the adoption or modification of a plan and the first planned trade; (2) by requiring corporate insiders to disclose publicly whether their trades are planned, and either (i) disclosing the plan or (ii) disclosing the plan adoption (or modification) date and the total amount of shares covered by the plan; and (3) by requiring that a Rule 10b5-1 plan that executes a single trade

³⁴ *Id.*

³⁵ See Promoting Transparent Standards for Corporate Insiders Act, H.R. 1528, 117th Cong. (Mar. 2, 2021) (introduced), <https://www.congress.gov/117/bills/hr/1528/BILLS-117hr1528ih.pdf>.

³⁶ Council of Institutional Investors, CII Policies, Statement on Stock Sales by Insiders (Mar. 10, 2020), https://www.cii.org/insider_stock_sales_statement; H.R. 1528, 117th Cong. § 2(a)(1) (describing amendments to Rule 10b5-1 generally consistent with CII policy).

³⁷ See H.R. 1528, 117th Cong. § 2(b) (“Not later than the end of the 1-year period beginning on the date of the enactment of this Act, the Commission shall issue a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate containing all findings and determinations made in carrying out the study required”).

³⁸ See *id.* § 2(c) (“After the completion of the study required under subsection (a), the Commission shall, subject to public notice and comment, revise Rule 10b5–1 consistent with the results of such study.”).

³⁹ See Automated Transcript for BGOV Floor Watch (Apr. 19, 2021) (on file with CII) (Rep. Perlmuter – floor speech) (noting CII’s support for H.R. 1528); Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Maxine Waters, Chairman, Committee on Financial Services (Jan. 22, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/January%2022,%202019%20Rule%2010b5-1%20Letter%20final.pdf (CII supporting the predecessor to H.R. 1528, the Promoting Transparent Standards for Corporate Insiders Act).

should disqualify the plan from an affirmative defense to insider trading.⁴⁰ We note that items (1) and (2) are generally consistent with CII's membership-approved policies and should be a component of a long overdue SEC proposed rule.⁴¹

Compensation, Discussion & Analysis (CD&A) Pay Target Metrics

As described on our website:

CII seeks improved transparency across a range of areas. These include the reconciliation to GAAP of non-GAAP metrics used to determine executive compensation⁴²

It is increasingly common for large public companies to disclose “adjusted earnings” or other financial measures that are not in accordance with GAAP. These non-GAAP financial measures often exclude costs such as stock compensation, asset impairments, legal settlements, restructurings, and intangible amortization. One study found that as many as 97% of companies in the S&P 500 used non-GAAP financial measures in 2017, up from 59% in 1996.⁴³

While non-GAAP financial measures can be useful in understanding a company's performance, they can be misused. Since 2003 the SEC has generally required companies to give equal prominence to GAAP and non-GAAP financial measures as well as provide a quantitative reconciliation of the numbers.⁴⁴

Yet an anomaly exists in that current SEC rules do not apply to the target measures for compensation contained in the CD&A section of a corporation's proxy statement.⁴⁵ One analysis revealed that that in 2018, more than two-thirds of S&P 500 companies used non-GAAP financial measures to establish compensation targets in CD&A.⁴⁶ That same analysis indicated

⁴⁰ See Caroline Crenshaw & Daniel Taylor, Finance, Insider Trading Loopholes Need to Be Closed, BloombergOpinion (Mar. 15, 2021) (on file with CII).

⁴¹ See Council of Institutional Investors, CII Policies, Statement on Stock Sales by Insiders (“For Rule 10b5-1 plans to fulfill their legitimate purpose, they should be: publicly disclosed; adopted when the participant is not in possession of material, non-public information; inactive for at least three months following adoption . . .”).

⁴² CII Advocacy Priorities – 2021, Corporate Disclosure.

⁴³ See Jessica McKeon, Long-Term Trends in Non-GAAP Disclosures: A Three-Year Overview, Audit Analytics (Oct. 10, 2018), <https://blog.auditanalytics.com/long-term-trends-in-non-gaap-disclosures-a-three-year-overview/> (“In 2017, 97% of the S&P 500 used at least one non-GAAP metric in their financial statement.”).

⁴⁴ See Conditions for Use of Non-GAAP Financial Measures, Securities Act Release No. 8,176, Exchange Act Release No. 47,226 (Jan. 23, 2002), <https://www.sec.gov/rules/final/33-8176.htm> (“Regulation G contains a general disclosure requirement and a specific requirement of a reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure.”).

⁴⁵ See, e.g., Kevin Douglas, Navigating the Maze: Which SEC Rules Apply to Your Non-GAAP Financial Measure Disclosures, Bass Berry & Sims, Sec. L. Exch. (Oct. 24, 2019), <https://www.bassberrysecuritieslawexchange.com/non-gaap-financial-measures-disclosure/> (“where non-GAAP financial measures are disclosed as a target metric for compensatory purposes, the applicable non-GAAP requirements . . . reconciliation, equal prominence, etc. . . do not apply”).

⁴⁶ See Olga Usvyatsky, Pros and Cons of Using Non-GAAP Metrics for Executive Compensation, Including ESG Considerations, Audit Analytics (June 11, 2019), <https://blog.auditanalytics.com/pros-and-cons-of-using-non-gaap-metrics-for-executive-compensation-including-esg-considerations/> (“In 2018, more than two-thirds of the S&P 500 companies used non-GAAP to establish compensation targets.”).

that about 30% of S&P 500 companies that used non-GAAP financial measures in the CD&A used identically labeled non-GAAP metrics in their earnings releases but calculated the measures differently.⁴⁷ Other research has indicated that non-GAAP metrics determined a significant percentage of CEO's annual cash bonuses, long-term stock awards, or both.⁴⁸

The CD&A is the most important source of information used by investors in evaluating executive compensation. Investors often struggle to make sense of how companies assess performance in approving large compensation packages.

The need for clarity is especially appropriate in the CD&A context because shareholders cast advisory votes on executive compensation regularly—every year at most public companies. The CD&A also informs investors' understanding of a corporation's governance more generally, and in voting on the election of directors.

In 2019, CII filed a petition with the SEC asking that the CD&A reports include an explanation of why non-GAAP measures are better for determining executive pay than GAAP, and that they include a quantitative reconciliation (or a hyperlink to reconciliation in another SEC filing) of these two sets of numbers.⁴⁹ More specifically, the petition requests that the Commission: (1) initiate a rule change to amend Item 402(b) of Regulation S-K to eliminate Instruction 5; and (2) revise the Division of Corporation Finance's Compliance & Disclosure Interpretations on Non-GAAP Financial Measures consistent with the aforementioned amendment and to provide that all non-GAAP financial measures presented in the proxy statement CD&A are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K and that the required reconciliation shall be included within the proxy statement or made accessible through a hyperlink in the CD&A.⁵⁰

In a December 2020 opinion piece in MarketWatch, Robert Pozen, a senior lecturer at the MIT Sloan School of Management and formerly vice chairman of Fidelity Investments and John

⁴⁷ See *id.* ("some firms will double-adjust executive compensation metrics by identically labeling metrics in both earnings releases and executive pay but calculating the metrics differently").

⁴⁸ See Nicholas Guest et al., High Non-GAAP Earnings Predict Abnormally High CEO Pay*, MIT, Sloan Sch. of Mgmt. 10 (May 2018), <https://www.hbs.edu/faculty/Shared%20Documents/conferences/2018-imo/GKP%20Non-GAAP%20Compensation%20Paper%20May%202018.pdf> ("For example, 38% of FirstEnergy's 2013 target CEO pay was granted for meeting a non-GAAP earnings target, 20% as an annual cash bonus and 18% as restricted stock.").

⁴⁹ See Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission at 2 (describing in bullet points the changes requested by the petition).

⁵⁰ See *id.* at 1 (CII "respectfully submits this petition to the Securities and Exchange Commission . . . requesting that the Commission (1) initiate a rule change to amend Item 402(b) of Regulation S-K [17 CFR 229.402(b)] . . . to eliminate Instruction 5; and (2) revise the Division of Corporation Finance's Compliance & Disclosure Interpretations on 'Non-GAAP Financial Measures' consistent with the aforementioned amendment and to provide that all non-GAAP financial measures presented in the proxy statement Compensation Discussion & Analysis are subject to the requirements of Regulation G [17 CFR 244.101-102] and Item 10(e) of Regulation S-K [17 CFR 10(c)] and that the required reconciliation shall be included within the proxy statement or made accessible through a hyperlink in the CD&A.").

Coates, now the Acting Director of the SEC's Division of Corporation Finance, advocated for making this issue a consensus agenda rulemaking item for the new SEC Chair.⁵¹

Some might argue that CII's rulemaking petition is unnecessary because companies will voluntarily improve their proxy disclosures to include a quantitative reconciliation or a hyperlink to a quantitative reconciliation in another SEC filing. In anticipation of that argument, we reviewed the 2020 and 2021 proxy statements of the seven companies highlighted in our petition as examples of companies in need of better non-GAAP disclosure: Abbott Laboratories, Advanced Micro Devices, Inc., Altice USA, Inc., Cisco Systems, Inc., Cogent Communications Holdings, Inc., Oracle Corporation and Revlon, Inc.⁵² It does not appear that any of the seven companies have to-date provided a quantitative Non-GAAP to GAAP reconciliation or a hyperlink to a Non-GAAP to GAAP quantitative reconciliation in their 2020 or 2021 CD&A's.⁵³ CII and many of its members agree that it is imperative that the SEC require at least the same level of transparency in the proxy statement CD&A as in other public company documents.

3. Markets Systems & Structure

Included in this category, is CII's support for "the Commission to adopt amendments to the proxy voting rules that would allow a shareholder voting by proxy to choose among duly-nominated candidates in a contested election of directors."⁵⁴ The Agenda categorizes this

⁵¹ See John Coates & Robert Pozen, FA Center, Opinion: New SEC Chair Needs to Tackle These Big Issues so the Government Can Do a Better Job for Investors, Mkt.Watch ("It should be a nonpartisan point of agreement to start a rulemaking process on the use of non-GAAP measures in compensation committee reports . . .").

⁵² See Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission at 3-4 n.7.

⁵³ See Abbott Laboratories, Schedule 14A at 36, 38, 40 (Mar. 12, 2021), <https://www.sec.gov/Archives/edgar/data/1800/000104746921000592/a2242988zdef14a.htm> (various "adjusted" measures); Advance Micro Devices, Inc., Schedule 14A at 48, 56 (Mar. 31, 2021), <https://www.sec.gov/Archives/edgar/data/2488/000119312521102463/d85905ddef14a.htm> (adjusted non-GAAP net income and adjusted non-GAAP free cash flow); Cisco Systems, Inc., Schedule 14A at 48 (Oct. 21, 2020), <https://www.sec.gov/Archives/edgar/data/858877/000119312520273689/d893355ddef14a.htm> (adjusted revenue and adjusted operating income); Cogent Communications Holdings, Inc., Schedule 14A at 43 (Apr. 28, 2021), https://www.sec.gov/Archives/edgar/data/1158324/000110465921032599/tm212366-1_def14a.htm (adjusted EBITDA "as defined in the Company's earnings releases"); Oracle Corporation, Schedule 14A at 40 (Sept. 18, 2020), <https://www.sec.gov/Archives/edgar/data/1341439/000119312520249194/d78987ddef14a.htm> ("non-GAAP pre-tax profit"); Abbott Laboratories, Schedule 14A at 34-36 (Mar. 13, 2020), <https://sec.report/Document/0001047469-20-001466/> (various "adjusted" measures); Advance Micro Devices, Inc., Schedule 14A at 40-43, 53 (Mar. 26, 2020), available at <https://seekingalpha.com/filing/4902379> (adjusted non-GAAP net income and Non-GAAP adjusted free cash flow); Altice USA, Inc., Schedule 14A at 19 (Apr. 24, 2020), <https://sec.report/Document/0001628280-20-005457/> (Adjusted EBITDA and Capex Adjusted EBITDA); Cisco, Notice of Annual Meeting of Shareholders and Proxy Statement 27 (Oct. 18, 2019), https://www.cisco.com/c/dam/en_us/about/annual-report/cisco-proxy-statement-2019.pdf (adjusted revenue and adjusted operating income); Cogent Communications Holdings, Inc., Schedule 14A at 25 (May 6, 2020), available at <https://www.marketwatch.com/investing/Stock/ccoi/SecFilings?subview=secarticle&sid=1949137&guid=14000964&type=313> ("adjusted EBITDA") (as defined in the Company's earnings releases"); Oracle Corporation, Schedule 14A at 36 (Sept. 27, 2019), <https://www.sec.gov/Archives/edgar/data/1341439/000119312519257430/d755300ddef14a.htm> ("non-GAAP pre-tax profit"); Revlon, Inc., Schedule 14A (Apr. 22, 2020), <https://sec.report/Document/0001140361-20-009411/> (includes no discussion of GAAP or non-GAAP targets).

⁵⁴ 86 Fed. Reg. at 17,042.

regulation as “Universal Proxy” in the “Final Rule Stage.”⁵⁵ Also included in this category, is our support for the Commission’s project on “Proxy Process Amendments” in the “Proposed Rule Stage.”⁵⁶ We assume the project’s omission from the federal register version of the Agenda was an oversight.⁵⁷

Universal Proxy

As described on our website:

On rare occasions, corporate director elections involve more candidates than available board seats, typically over a dispute about the company’s direction between incumbent board members and an activist investor. In these proxy contests, it makes common sense that shareowners should be able to support whatever combination of nominees they wish to represent them.

But under current rules, shareholders generally have that choice only if they vote in person. Shareholders voting by proxy (the vast majority of investors), 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. That is because neither company management nor dissidents are required to include all bona fide candidates on their proxy cards.

To fix this, CII **sought and supported** amending director election rules to require universal proxy cards that ensure “full flexibility” on both management’s and the dissident’s card. The SEC proposed a universal proxy rule in 2016 but has not finalized the rulemaking. CII continues to **advocate** for the adoption of a final rule to get this sensible reform across the finish line.⁵⁸

Last month, in a speech at the Center for American Progress, SEC Acting Chair Lee stated that she has “asked the staff to consider whether to recommend that the Commission re-open the comment file on the 2016 universal proxy rule proposal to take into account market developments since then and move towards finalization.”⁵⁹ She also stated that the “proposal has been outstanding for far too long and should be finalized.”⁶⁰

⁵⁵ *Id.* at 17,040.

⁵⁶ Office of Information & Regulatory Affairs, Office of Management & Budget, Agency Rule List – Fall 2020, Securities and Exchange Commission (last visited Apr. 14, 2021), https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=1911DFC1D3AC775E5263F9542EDD2A65C32061AABEC9879EADF78334AAA550DFB8B8EF7A2A90E0DAC9394FA28EE22339E0CE.

⁵⁷ *See* 86 Fed. Reg. at 17,043-44.

⁵⁸ CII Advocacy Priorities – 2021, Market Systems & Structure (Apr. 22, 2021), https://www.cii.org/market_systems_structure.

⁵⁹ Acting Chair Allison Herren Lee, A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC (Mar. 15, 2021), <https://www.sec.gov/news/speech/lee-climate-change>.

⁶⁰ *Id.*

On April 16, 2021, the Commission reopened the comment period for the 2016 universal proxy rule proposal.⁶¹ SEC Acting Chair Lee stated that the action was “an important step toward finalizing rules that will facilitate clarity and efficiency for shareholders voting in direct elections.”⁶² CII looks forward to the long overdue final rule on universal proxy.

Proxy Process Amendments

As described on our website:

As shareholder voting is a core and essential element of corporate governance, shareholders have a keen interest in a reliable, transparent and cost-effective system for voting proxies. Yet the U.S. system of proxy voting is extraordinarily complex and inefficient. Many CII members lack confidence that their shares are always fully and accurately voted. Since 2010, market intermediaries have worked to develop a system to provide vote confirmation on request. But vote confirmation is not routine, easy or efficient. CII **believes** the SEC should explore steps it could take to require the various intermediaries that process proxy votes to cooperate to ensure that shareholders’ votes are counted accurately, and that proxy voters can confirm vote execution with a few clicks on a keyboard.⁶³

We note that in February 2021, the House Financial Services Committee Ranking Member and the Senate Banking Committee Ranking Member urged the Commission to address these “proxy plumbing” issues stating:

In 2010, the SEC issued an ANPRM regarding “proxy plumbing.” Concerns about under-voting, over-voting, and verification of proxy votes have not been fully addressed through changes to SEC rules. The SEC should move forward with efforts to ensure the integrity of the proxy voting process.⁶⁴

And we share the following concerns about proxy plumbing raised last month by SEC Acting Chair Lee:

. . . . [w]hen funds and advisers exercise their authority to vote, it is often difficult to obtain vote confirmations given the multitude of intermediaries involved in the voting process, from transfer agents to tabulators. While accuracy of vote confirmations has been a persistent concern, so has timeliness of these vote confirmations. Commenters have suggested tackling this issue in a variety of ways, such as requiring intermediaries, including transfer agents, to transmit the necessary information to confirm votes, while others have suggested that we explore use of a

⁶¹ Press Release, SEC Reopens Comment Period for Universal Proxy (Apr. 16, 2021), <https://www.sec.gov/news/press-release/2021-64>.

⁶² *Id.*

⁶³ CII Advocacy Priorities – 2021, Market Systems & Structure.

⁶⁴ Letter from Pat Toomey, Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs & Patrick McHenry, Ranking Member, House Committee on Financial Services to The Honorable Allison Herren Lee, Acting Chair, Securities and Exchange Commission (Feb. 15, 2021), https://www.banking.senate.gov/imo/media/doc/Toomey_McHenry_SEC_GoodGovernment.pdf.

permissioned blockchain to record beneficial ownership and execute votes. Both of these issues – problems obtaining a quorum and problems confirming fund votes – deserve attention as we examine and attempt to modernize our proxy voting system.⁶⁵

Also last month, SEC Acting Director Coates indicated that improvements in proxy plumbing should be one of the Commission’s top priorities.⁶⁶ We agree. In addition to finalizing the rule on universal proxy, we believe the SEC should prioritize as a next step⁶⁷ mandating end-to-end vote confirmation in connection with its current project on “Proxy Process Amendments.”⁶⁸

⁶⁵ Acting Chair Allison Herren Lee, Every Vote Counts: The Importance of Fund Voting and Disclosure, Address Before the 2021 ICI Mutual Funds and Investment Management Conference (May 17, 2021) (footnotes omitted), <https://www.sec.gov/news/speech/lee-every-vote-counts>.

⁶⁶ See Christina Thomas, Updates from the SEC’s Acting Director of the Division of Corporation Finance, Mayer Brown Free Writings + Perspectives (Apr. 8, 2021), *available at* <https://www.jdsupra.com/legalnews/updates-from-the-sec-s-acting-director-9823287/> (“Acting Director Coates, when asked about his priorities at the SEC, mentioned three items: the ‘unprecedented surge’ in special purpose acquisition company (SPAC) filings, reporting company ESG disclosures (including disclosure of climate change and potentially political spending), and improvement of the proxy voting system (commonly referred to as ‘proxy plumbing’)”); *see also* Transcript of U. S. Securities and Exchange Commission Investor Advisory Committee Meeting (Mar. 13, 2021) (on file with CII) (member of Investor as Owner Subcommittee stating that “we’d love to see some progress on that front [proxy plumbing] in 2021”).

⁶⁷ CII believes other steps should include pursuing rulemaking to require or permit the use of new technologies that would address, among other proxy issues, the traceability of shares. *See, e.g.*, Petition of Council of Institutional Investors for Review of an Order, Issued by Delegated Authority, Granting Approval of a Proposed Rule, Exchange Act Release No. 898 at 11 (Sept. 8, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/20200908%20Letter%20to%20SEC%20w%20attachments.pdf (“The Council believes – and has long believed – that traceability problems of the sort raised here should impel the Commission to update its ‘proxy plumbing’ regulations”); *see also* Rutgers Cent. for Corp. L. & Gov. et al., Report of the 2020 Multi-Stakeholder Working Group on Practices for Virtual Shareholder Meetings 3 (Dec. 10, 2020), https://cclg.rutgers.edu/wp-content/uploads/VSM-Working-Group-Report-12_10_2020.pdf (“the 2020 Working Group [which included CII] was in strong agreement that solutions to proxy plumbing-related issues are essential for all shareholders entitled to vote at all [virtual shareholder meetings], no matter which service provider ‘hosts’ the meeting.”).

⁶⁸ *See* John Coates & Robert Pozen, FA Center, Opinion: New SEC Chair Needs to Tackle These Big Issues so the Government Can Do a Better Job for Investors, Mkt.Watch (opining that in recent years the Securities and Exchange Commission could have mandated “end-to-end vote confirmation that could improve proxy ‘plumbing,’ [but instead] the SEC set out examples of how proxy advisors could be sued.”); *see also* Cydney Posner, Blog: Coates Named Acting Director of Corp Fin, Pub@Cooley, *available at* <https://www.jdsupra.com/legalnews/blog-coates-named-acting-director-of-9232130/> (providing background on John Coates and the proxy plumbing issue, including end-to-end vote confirmation).

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Thank you for consideration of our views. If we can answer any questions or provide additional information on the Commission's regulatory agenda, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, reading "Jeff Mahoney". The signature is written in a cursive, flowing style.

Jeffrey P. Mahoney
General Counsel