

Via Email

April 8, 2022

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

Re: *File No. S7-06-22*

Dear Ms. Countryman:

On behalf of the Council of Institutional Investors (CII or Council), we respectfully submit our comments on the proposed amendments to “certain rules that govern beneficial ownership reporting” (Release).<sup>1</sup>

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.<sup>2</sup>

### **Introduction and Overview**

Council members believe that effective corporate governance and disclosure serve the best long-term interests of companies, shareowners and other stakeholders. Effective corporate governance helps companies achieve strategic goals and manage risks by ensuring that shareowners can hold directors to account as their representatives, and in turn, directors can hold management to account, with each of these constituents contributing to balancing the interests of the company’s varied stakeholders.<sup>3</sup>

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<sup>1</sup> See Modernization of Beneficial Ownership Reporting, Securities Act Release No. 11,030, Exchange Act Release 94,211, 87 Fed. Reg. 13,846, 13,846 (Feb. 10, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-03-10/pdf/2022-03222.pdf>.

<sup>2</sup> 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>.

<sup>3</sup> See, e.g., CII Research and Education Fund, What is Corporate Governance? Why is it important to you? (2018), <https://www.ciiref.org/whatiscorporategovernance>.

CII members use a variety of stewardship tools to improve corporate governance and disclosure at the companies they own. These tools include casting well-informed proxy votes; engaging in dialogue with portfolio companies (including with board members, as appropriate), external managers, other investors and policymakers; filing shareholder resolutions; nominating board candidates; litigating meritorious claims; and retaining or dismissing third parties charged with assisting in carrying out these activities.

## Discussion

The Release proposes a number of changes to the current Rules 13D and 13G, among them a shortening the reporting period, a re-definition of the concept of a “group,” a proposal to treat the holders of certain cash-settled derivatives as beneficial owners under these rules and to impose certain disclosure requirements on those holders.<sup>4</sup> CII does not intend to comment on those features, but will instead limit these comments to the proposed Rule 13d-6(c), which, according to the summary to the rule, is intended to “clarify and affirm the operation”<sup>5</sup> of Rules 13D and 13G in order to permit investors, such as CII member funds, “to communicate and consult with each other, jointly engage issuers and execute certain transactions without being subject to regulation as a group.”<sup>6</sup>

This clarification is important to CII members, who often communicate with each other and with other shareholders regarding corporate governance issues at portfolio companies. In addition, CII members may collaborate with other shareholders to engage with board members and management at specific companies on issues of concern. These collaborations may involve engagement with individual companies on matters specific to that company. In addition, CII members have joined several investor coalitions that came together to address specific topics on a broader scale.

Our experience indicates that these types of dialogues are beneficial to investors and companies alike. Such engagements do not raise any issues with respect to control of a company or efforts to influence control at a given company. Indeed, these engagements reflect the sort of communications and dialogues that the Securities and Exchange Commission (Commission) has been promoting for the past 30 years, starting with *Regulation of Communications Among Shareholders*, Release No. 34–31,326, 57 Fed. Reg. 48,276 (Oct. 22, 1992). And CII generally opposes regulatory proposals that might unduly limit or eliminate such engagements.<sup>7</sup>

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<sup>4</sup> 87 Fed. Reg. at 13,846.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> For example, in February 2021 CII opposed interpretations of the Hart-Scott-Rodino pre-merger notification requirements that could have hamper the sort of communications that are at issue in this rulemaking. *See* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Federal Trade Commission, Office of the Secretary, April Tabor, Acting Secretary 2 (Feb. 1, 2021), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2021/February%201%202021%20FTC%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/February%201%202021%20FTC%20letter%20(final).pdf) (“CII believes that the FTC’s existing narrow interpretation of its investment-only exemption is inconsistent with promoting issuer and investor engagement about corporate governance best practices”); *see also* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association & Jeff Mahoney, General Counsel, Council of Institutional Investors to Mr. Donald S. Clark, Secretary of the Commission, Federal Trade Commission 10 (Aug. 13, 2018), [https://www.ftc.gov/system/files/documents/public\\_comments/2018/08/ftc-2018-0048-d-0010-147719.pdf](https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0048-d-0010-147719.pdf) (“The

CII welcomes the proposed adoption of Rule 13d-6(c)<sup>8</sup> as a way to clarify the rules of engagement in this area and to avoid chilling communications between shareholders and with portfolio companies.

The Council’s position, in brief, is as follows:

- Much has changed in terms of how shareholders engage with portfolio companies and with other shareholders since this rule was last updated. Any revision to the rule should ensure that current forms of engagement — such as “vote no” campaigns and efforts to change management discussed below— should continue.
- There are ambiguities in the text of both prongs of the proposed Rule 13d-6(c) that should be addressed in any final rule to avoid chilling shareholder communications.

### Forms of engagement

#### *“Vote No” Campaigns*

The Council would urge the Commission to clarify that the exemption in proposed Rule 13d-6(c) is available to shareholders engaged in “vote no” campaigns regarding individual board candidates in uncontested director elections.

Over the last 20 years, director elections have moved from being a pro forma exercise, where the management slate is always elected, to a regime in which shareholders can vote “no” against particular directors, as opposed to simply “withholding” their proxy. In addition, many companies have amended their bylaws to adopt a “majority vote” standard. If the “no” votes for a given candidate exceed the “yes” votes, the director is generally expected to resign, but the board has discretion not to accept such a candidate’s resignation.

Council policies oppose the continuation of a director’s service if he or she is not elected.<sup>9</sup> Nonetheless, we submit that “vote no” campaigns have emerged in recent years and should be permitted under the proposed exemption.<sup>10</sup>

As a practical matter, such campaigns do not involve issues of control, but provide a useful means for shareholders to focus on the performance of individual directors without involving the sort of control issues that prompted adoption of section 13 of the Securities Exchange Act of 1934 and Rule 13D. For example, if shareholders believe that a company’s executive compensation policies are flawed, do not promote principles of “pay for performance,” or

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Agencies’ Restrictive Interpretation of the Investment-Only Exemption Serves No Competitive Purpose and Chills Shareholder Engagement with Issuers.”).

<sup>8</sup> See 87 Fed. Reg. at 13,898-99 (proposed § 240.13d-6 Exemption of certain acquisitions).

<sup>9</sup> Council of Institutional Investors, Corporate Governance Policies § 2.2 Director Elections (updated Mar. 7, 2022) [https://www.cii.org/files/03\\_07\\_22\\_corp\\_gov\\_policies.pdf](https://www.cii.org/files/03_07_22_corp_gov_policies.pdf) (“any director who does not receive the majority of votes cast should leave the board as soon as practicable”).

<sup>10</sup> See, e.g., Paul Verney, Governance, New York City launches ‘vote no’ campaign against JP Morgan Chase director citing climate change, Responsible Investor (Apr. 23, 2020), <https://www.responsible-investor.com/new-york-city-launches-vote-no-campaign-against-jp-morgan-chase-director-citing-climate-change/>.

otherwise constitute poor pay practices,<sup>11</sup> there is value in being able to launch a “vote no” campaign against the chair and possibly other members of the board’s compensation committee. Such campaigns exist at this time, with the proponents often posting exempt solicitations to other shareholders on the Commission’s EDGAR system. The Council sees no reason to exclude such efforts or similar efforts from the exemption in proposed Rule 13d-6(c).

### *Change Management*

CII policies recognize that a core responsibility of the board is to recruit, retain and when necessary, replace the chief executive on behalf of the owners of the company.<sup>12</sup> CII would urge the Commission to clarify that the exemption under Rule 13d-6(c) is available to shareholders who do not seek to change or influence control of the board, but who engage with the company and/or other shareholders regarding the need for new management leadership.

### The two prongs of proposed Rule 13d-6(c)

To qualify for the proposed Rule 13d-6(c) exemption there is a two pronged test: “(1) Communications among or between such persons are not undertaken with the purpose or the effect of changing or influencing control of the issuer, and are not made in connection with or as a participant in any transaction having such purpose or effect, including any transaction subject to § 240.13d-3(b); and (2) Such persons, when taking such concerted actions, are not directly or indirectly obligated to take such actions.”<sup>13</sup>

### *Prong Two*

We generally agree with the reasoning behind prong two of the proposed Rule 13d-6(c) exemption, when it says that this prong would be available to investors who, “when taking such concerted actions, are not directly or indirectly obligated to take such actions.”<sup>14</sup> The Release further explains that one would be “directly or indirectly obligated” to take joint action, “e.g., pursuant to the terms of a cooperation agreement or joint voting agreement.”<sup>15</sup>

The Council views this “no obligation” concept as central to the scope of any exemption in this area. When CII members take joint action, they are acting independently, consistent with their fiduciary, legal and other obligations to their fund participants and beneficiaries.

All understandings are informal and without written agreements. Being a “member” of an investor coalition of the sort described above does not obligate an individual fund, either “directly” or “indirectly,” to take specific actions unless that fund chooses to do so.

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<sup>11</sup> See § 5.8 Poor Pay Practices.

<sup>12</sup> See § 2.7 Board’s Role in Strategy and Risk Oversight (“A core function of the board is to oversee the performance of the CEO to ensure that an optimal strategy is pursued and appropriate risk mitigation policies are adopted and executed.”).

<sup>13</sup> 87 Fed. Reg. at 13,899.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 13,873.

CII supports the concept that the exemption should be available so long as no “obligation” exists pursuant to an underlying agreement of the sort cited in the explanatory text above. However, the text of the proposed subsection (c)(2) is not explicit about the underlying source of any obligation. Instead, as indicated, the proposed text of the rule simply says that the exemption is available if “[s]uch persons, when taking such concerted actions, are not directly or indirectly obligated to take such actions.”

The Council respectfully recommends that the Commission revise the language of the second prong of the proposed exemption to clarify this point or perhaps to delete the word “indirectly” as unnecessary.

### *Prong One*

Prong one of the proposed Rule 13d-6(c) exemption also creates ambiguities that could be harmful to the sort of productive engagements that now exist as a matter of course between CII members, other investors and corporate boards and managers. Despite the language quoted above about the need for evidence of an “obligation” such as a cooperation agreements or joint voting agreements, other portions of the Release propose to change the definition of “group” such that an agreement would be a sufficient, but not a necessary reason to conclude that a “group” has been formed.<sup>16</sup>

At this point the picture is blurred: It is highly likely that a “group” formed under Rule 13D will seek to engage with CII members and other investors. Indeed, it is quite common for Rule 13D “groups,” when engaged in a contested director election or similar activity, to reach out to investors to explain their arguments for supporting the “group’s” endeavors, candidates, etc. The law is clear that such dialogues can occur and that investors who are persuaded by a “group’s” arguments can vote their shares and communicate with other shareholders.

But if a CII member fund (or set of funds) should engage in such activities with a Rule 13D “group,” what actions would have to occur in order to conclude that the fund is no longer acting independently, but is “acting as” a member of the Rule 13D “group”? The Release speaks of looking at the “facts and circumstances” in individual cases, but that does not provide adequate guidance as to the situations we raise here.<sup>17</sup>

There is a tension in the proposed rule that needs to be addressed and clarified. On the one hand, the Release indicates that the exemption of Rule 13d-6(c) is available so long as there is not an “agreement” such as a cooperation agreement or joint voting agreement. On the other hand, the Release proposes expanding the definition of a “group” to cover not simply investors bound by an agreement, but others whose conduct suggests that they are “acting as” part of a “group.”

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<sup>16</sup> See *id.* at 13,848 (“By conforming the rule text to Sections 13(d)(3) and 13(g)(3), the proposed amendments to Rule 13d-5 are intended to remove the potential implication that an express or implied agreement among group members is a necessary precondition to the formation of a group under those provisions of the Exchange Act and, by extension, Regulation 13D-G.”).

<sup>17</sup> *Id.* at 13,868.

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Our concern is that the positive step taken by adopting Rule 13d-6(c) could be undercut if there is a concern among investors that communicating with a Rule 13D “group” could expose investors to being considered as a part of that “group.” The concern is underscored by the language in prong one of proposed Rule 13d-6(c) indicating that the exemption would not cover communications “made in connection with” a control-related transaction or communications made “as a participant” in such a transaction.

The Council respectfully recommends that the Commission re-examine and revise the “in connection with” language in prong one of proposed Rule 13d-6(c), as it might be read too broadly and have an unintended chilling effect of the sort of communications that routinely occur today.

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CII appreciates the opportunity to submit comments on the Proposed Rule and is available to provide any additional information the Commission requests.

Sincerely,

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

Jeff Mahoney  
General Counsel