

Via E-Mail

September 7, 2022

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

*Re: File No. S7-15-22*

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.<sup>1</sup>

This letter is in response to the Securities and Exchange Commission’s (SEC or Commission) invitation to comment on its semiannual regulatory agenda (Agenda).<sup>2</sup> In responding to the Agenda, we note that CII’s current SEC rulemaking priorities fall into the following three categories: (1) Investor Rights and Protections; (2) Corporate Disclosure; and (3) Market Systems & Structure.<sup>3</sup>

## **1. Investor Rights and Protections**

We include under this heading our support for completed action on “Listing Standards for Recovery of Erroneously Awarded Compensation.”<sup>4</sup> We continue to believe the Commission

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<sup>1</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>2</sup> Regulatory Flexibility Agenda, Securities Act Release No. 11,054, Exchange Act Release No. 94,793, Investment Adviser Act Release No. 6,002, Investment Company Act Release No. 34,570, 87 Fed. Reg. 48,424 (Aug. 8, 2022), <https://www.federalregister.gov/documents/2022/08/08/2022-15035/regulatory-flexibility-agenda>.

<sup>3</sup> See Council of Institutional Investors, CII Advocacy Priorities (2022), [https://www.cii.org/advocacy\\_priorities](https://www.cii.org/advocacy_priorities).

<sup>4</sup> Council of Institutional Investors, CII Advocacy Priorities, Investor Rights & Protections (2022), [https://www.cii.org/investor\\_rights\\_protections](https://www.cii.org/investor_rights_protections).

should bring this important and long-standing Congressionally mandated rulemaking<sup>5</sup> to an appropriate conclusion by promptly issuing a final rule.<sup>6</sup>

### Listing Standards for Recovery of Erroneously Awarded Compensation

CII has long advocated for implementation of Section 954 of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and adoption of a rule to require clawbacks of unearned executive compensation in certain circumstances.<sup>7</sup> As described on CII's website and as generally reflected in our membership-approved corporate governance policies:<sup>8</sup>

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.

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<sup>5</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 954 (July 21, 2010), available at <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf> (“SEC. 10D. RECOVERY OF ERRONEOUSLY AWARDED COMPENSATION POLICY. ‘(a) LISTING STANDARDS.—The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not comply with the requirements of this section. ‘(b) RECOVERY OF FUNDS.—The rules of the Commission under subsection (a) shall require each issuer to develop and implement a policy providing— ‘(1) for disclosure of the policy of the issuer on incentive based compensation that is based on financial information required to be reported under the securities laws; and ‘(2) that, in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer of the issuer who received incentive based compensation (including stock options awarded as compensation) during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.’”).

<sup>6</sup> See, e.g., Letter from Lucy Nussbaum, Senior Research Analyst, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 1-2 (Feb. 24, 2022), [https://www.cii.org/files/Reg%20Flex%20Letter%20final%2024\\_22.pdf](https://www.cii.org/files/Reg%20Flex%20Letter%20final%2024_22.pdf) (“We are pleased that the Commission reopened the comment period for the proposed rules to implement the clawback requirements in Section 954 of Dodd-Frank, and believe this long-standing project should be advanced to the ‘Final Rule Stage’ and a final rule promptly issued.”).

<sup>7</sup> See, e.g., Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 4 (Aug. 27, 2015), <https://www.sec.gov/comments/s7-12-15/s71215-8.pdf> (“In light of our past and present policies and related public positions on clawbacks, CII generally supports the Proposal.”).

<sup>8</sup> See Council of Institutional Investors, Corporate Governance Policies, § 5.7 Compensation Recovery (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) (“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.”).

[W]e acknowledge[] that many U.S. companies have adopted claw back policies that go further than Dodd-Frank requirements. But CII [continues to] support . . . a baseline rule for all listed companies consistent with the intent of the Dodd-Frank requirements.<sup>9</sup>

We share SEC Chair Gary Gensler’s view that the clawback rule mandated by Section 954 of Dodd-Frank would “strengthen the transparency and quality of corporate financial statements as well as the accountability of corporate executives to their investors.”<sup>10</sup> As you are aware, the Commission recently reopened for the second time the comment period for its 2015 proposed rule<sup>11</sup> to solicit input on a June memorandum of the SEC’s Division of Economic and Risk Analysis (June Release)<sup>12</sup> entitled “Supplemental data and analysis on the voluntary adoption of compensation recovery provisions by issuers and the impact of including ‘little r’ restatements as triggers for a compensation recovery analysis” (DERA Memo).<sup>13</sup>

In the June Release, the Commission identified three issues relating to the DERA Memo.<sup>14</sup> CII’s comment letter in response to the June Release (June Letter)<sup>15</sup> addressed each issue, as summarized below:

- 1) The voluntary adoption of clawback policies exceeding the requirements of Section 954 of Dodd-Frank does not change our view that it is in the best interests of investors to proceed directly to a final rule;<sup>16</sup>

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<sup>9</sup> Council of Institutional Investors, CII Advocacy Priorities, Investor Rights & Protections.

<sup>10</sup> Chair Gary Gensler, Statement on Rules Regarding Clawbacks of Erroneously Awarded Compensation (Oct. 14, 2021), <https://www.sec.gov/news/public-statement/gensler-clawbacks-2021-10-14>.

<sup>11</sup> See Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 9,861, Exchange Act Release No. 75,342, Investment Company Act Release No. 31,702, 80 Fed. Reg. 41,144 (proposed rules July 14, 2015), <https://www.govinfo.gov/content/pkg/FR-2015-07-14/html/2015-16613.htm>.

<sup>12</sup> See Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 11,071, Exchange Act Release No. 95,057, Investment Company Act Release No. 34,610, 87 Fed. Reg. at 35,938 (June 14, 2022), <https://www.federalregister.gov/documents/2022/06/14/2022-12792/reopening-of-comment-period-for-listing-standards-for-recovery-of-erroneously-awarded-compensation>.

<sup>13</sup> See Memorandum from Division of Economic and Risk Analysis, Supplemental data and analysis on the voluntary adoption of compensation recovery provisions by issuers and the impact of including “little r” restatements as triggers for a compensation recovery analysis (June 8, 2022), <https://www.sec.gov/comments/s7-12-15/s71215-20130560-298718.pdf>.

<sup>14</sup> See 87 Fed. Reg. at 35,938-39 (“the staff memorandum (i) discusses the increase in voluntary adoption of compensation recovery policies by issuers; (ii) provides estimates of the number of additional restatements that would trigger a compensation recovery analysis if, as the Commission described in the Reopening Release, the rules were extended to include all required restatements made to correct an error in previously issued financial statements; and (iii) briefly discusses some potential implications for the costs and benefits of the proposed rules”).

<sup>15</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 2 (June 24, 2022), <https://www.sec.gov/comments/s7-12-15/s71215-20133881-303799.pdf>.

<sup>16</sup> See *id.* at 3; see also Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 9 (Nov. 18, 2021), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2021/November%2018%202021%20SEC%20clawback%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/November%2018%202021%20SEC%20clawback%20letter%20(final).pdf) (“CII acknowledges that there have been a number of developments since the Proposed Rule relating to clawbacks, most notably the voluntary adoption by some companies of clawback policies that go beyond the requirements of Section 954 of Dodd-Frank [and] [w]e, however, continue to believe that it is in the best

- 2) The final rule should encompass both little r and Big R types of restatements, consistent with the intent of Section 954;<sup>17</sup> and
- 3) On balance, the potential implications for the costs and benefits of the 2015 proposed rule provide a net benefit to investors and the capital markets.<sup>18</sup>

Overall, as in indicated in the June Letter, CII believes the DERA Memo further supports our view that the Commission should promptly issue this long overdue rule.

## 2. Corporate Disclosure

We include under this heading our support for the Commission’s recent issuance of the long overdue final rule on “Pay Versus Performance,”<sup>19</sup> and our support for adding a new project to the Agenda to close a loophole in the regulation governing the use of non-Generally Accepted Accounting Principles (GAAP) metrics.<sup>20</sup> We also include under this heading our support for the prompt issuance of a final rule on the Agenda project “Rule 10b5-1 and Insider Trading”<sup>21</sup> to reform and improve disclosure of Rule 10b5-1 trading plans.<sup>22</sup>

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interests of investors for the Commission to finally bring this long overdue, Congressionally mandated rulemaking to a close by issuing a final rule.”).

<sup>17</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 4 (“CII believes excluding little r restatements from the required clawback policy would likely not only further exacerbate this opportunistic behavior to reduce the transparency of restatements to investors, but more importantly limit the ability of the required clawback policy to recover for shareowners the executive pay that was unearned and erroneously awarded.”); *see generally*, Reporting Misstatements as Revisions with Professor Rachel Thompson, Voice Corp. Governance (Jan. 18, 2022) (discussing empirical evidence on little r and Big R restatements), <https://www.cii.org/podcasts>.

<sup>18</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 6-7 (“On balance, CII believes the potential implications for the costs and benefits of the Proposed Rule as a result of the (1) increase in the number of companies with voluntarily adopted compensation recovery provisions since 2015, and (2) inclusion of ‘little r’ restatements as described in the October Release and supported in the November Letter provides a net benefit to investors and the capital markets and further supports our view that the Commission should promptly issue this long overdue rule.”).

<sup>19</sup> 87 Fed. Reg. at 48,424 (categorizing “Pay Versus Performance” in the “FINAL RULE STAGE”).

<sup>20</sup> See Council of Institutional Investors, CII Advocacy Priorities, Corporate Disclosure (2022), [https://www.cii.org/corporate\\_disclosure](https://www.cii.org/corporate_disclosure) (“Transparency of executive compensation”).

<sup>21</sup> Agency Rule List - Spring 2022, Securities and Exchange Commission, Off. Info. & Reg. Aff., Off. Mgmt. & Budget (last visited Sept. 6, 2022), [https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION\\_GET\\_AGENCY\\_RULE\\_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf\\_token=ABBAA84824C29E01B566B0472A6E99E59C730916821A14613C79DE7F48AC8EAEF4CA3A7C929E9B10E667F119BAA4958D5293](https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=ABBAA84824C29E01B566B0472A6E99E59C730916821A14613C79DE7F48AC8EAEF4CA3A7C929E9B10E667F119BAA4958D5293) (categorizing “Rule 10b5-1 and Insider Trading” in the “Final Rule Stage”).

<sup>22</sup> See Council of Institutional Investors, CII Advocacy Priorities, Corporate Disclosure (“Transparency and safeguards around executive trading in company stock”).

## Pay Versus Performance

CII applauds the SEC’s recent issuance of a final rule on “Pay Versus Performance.”<sup>23</sup> We had long advocated for implementation of Section 953(a) of Dodd-Frank<sup>24</sup> and adoption of a rule to provide additional quantitative information illustrating the relationship between executive compensation and the financial performance of the issuer.<sup>25</sup> And we agree with SEC Commissioner Mark T. Uyeda that “it is unacceptable for more than twelve years to elapse before fulfilling a Congressional mandate.”<sup>26</sup>

As described on CII’s website and as generally reflected in our membership-approved corporate governance policies:<sup>27</sup>

Executive compensation is the most critical and visible aspect of a company’s corporate governance. Directors’ decisions about CEO pay speak volumes about the board’s accountability to shareowners. . . . In late January, the SEC reopened the comment period for rules the agency originally proposed in 2015<sup>[28]</sup> to implement a section of Dodd-Frank that requires companies to disclose information about the relationship between actual executive pay, as reported in the proxy (with certain adjustments), and company performance, as represented by total shareholder return.<sup>29</sup>

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<sup>23</sup> See Pay Versus Performance, Exchange Act Release No. 95,607 (Aug. 25, 2022), <https://www.sec.gov/rules/final/2022/34-95607.pdf>.

<sup>24</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 953(a) (“DISCLOSURE OF PAY VERSUS PERFORMANCE.—Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n), as amended by this title, is amended by adding at the end the following: ‘(i) DISCLOSURE OF PAY VERSUS PERFORMANCE.—The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer a clear description of any compensation required to be disclosed by the issuer under section 229.402 of title 17, Code of Federal Regulations (or any successor thereto), including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions [and] [t]he disclosure under this subsection may include a graphic representation of the information required to be disclosed.’”).

<sup>25</sup> See, e.g., Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Keith F. Higgins, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission 7 (Aug. 13, 2013), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2013/08\\_16\\_13\\_cii\\_letter\\_to\\_sec\\_pay\\_vs\\_performance.pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2013/08_16_13_cii_letter_to_sec_pay_vs_performance.pdf) (indicating that CII was an active proponent of Section 953(a) of Dodd-Frank Act and had an interest in how the Securities and Exchange Commission intended to implement the rule).

<sup>26</sup> SEC Commissioner Mark T. Uyeda, Statement on the Final Rule Related to Pay Versus Performance (Aug. 25, 2022), <https://www.sec.gov/news/statement/uyeda-statement-final-rule-related-pay-versus-performance-082522>.

<sup>27</sup> See Council of Institutional Investors, Corporate Governance Policies, § 5.3 Transparency of Compensation (“To the extent that compensation is performance-based, it is critical that investors have information to evaluate the choice of metrics, how those metrics relate to key company strategic goals, and how challenging the goals are.”)

<sup>28</sup> See Pay Versus Performance, Exchange Act Release No. 74,835, 80 Fed. Reg. 26,330 (proposed rule May 27, 2015), <https://www.federalregister.gov/documents/2015/05/07/2015-10429/pay-versus-performance>.

<sup>29</sup> Council of Institutional Investors, CII Advocacy Priorities, Investor Rights & Protections.

In February, CII submitted a letter to the SEC in response to the January reopening of the comment period (February Letter).<sup>30</sup> We commend the SEC for adopting in the final rule recommendations contained in the February Letter, including:

- “requiring additional financial performance measures beyond total shareholder return,”<sup>31</sup>
- “defining the ‘Company-Selected Measure’ as the measure that in the registrant’s assessment represents the most important performance measure (that is not already included in the table) used by the registrant to link compensation actually paid during the fiscal year to company performance,”<sup>32</sup> and
- “requiring that all registrants, including SRCs, use Inline eXtensible Business Reporting Language (XBRL) to tag their pay versus performance disclosures, including specific data points (such as quantitative amounts) within footnote disclosures that would be block-text tagged.”<sup>33</sup>

CII generally agrees with SEC Chair Gensler “that this rule will help investors receive the consistent, comparable, and decision-useful information they need to evaluate executive compensation policies.”<sup>34</sup> We also share the view of a corporate compensation consultant who recently opined that the rule “continues the trend of pushing companies to better tell their story, and so it’s important to not fall into the trap of just filling out the table, but rather spend time crafting the narrative to really help the reader understand how your pay and performance are aligned.”<sup>35</sup> That said, CII is disappointed that the final rule did not include the February Letter recommendation to “amend Item 402(b) of Regulation S-K [<sup>36</sup>] to close a loophole that permits the use of non-GAAP measures in the [Compensation, Discussion & Analysis] CD&A without

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<sup>30</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission (Feb. 24, 2022), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2022/February%202024,%202022%20CII%20P4P%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/February%202024,%202022%20CII%20P4P%20letter%20(final).pdf).

<sup>31</sup> *Id.* at 4; see Pay Versus Performance at 223 (“Net income of the registrant”).

<sup>32</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 5 (footnote omitted); see Pay versus Performance at 221-22 (“the Company-Selected Measure, which in the registrant’s assessment represents the most important financial performance measure (that is not otherwise required to be disclosed in the table) used by the registrant to link compensation actually paid to the registrant’s named executive officers, for the most recently completed fiscal year”).

<sup>33</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 11; see Pay versus Performance at 212 (“Both SRCs and non-SRC registrants are required to separately tag the values disclosed in the table in Inline XBRL, block-text tag the footnote and relationship disclosure and the Tabular List in Inline XBRL, and tag specific data points (such as quantitative amounts) within the footnote disclosures in Inline XBRL, but SRCs are required to provide the required Inline XBRL data beginning in the third filing in which they provide pay-versus-performance disclosure”).

<sup>34</sup> Press Release, Securities and Exchange Commission, SEC Adopts Pay Versus Performance Rules (Aug. 25, 2022), <https://www.sec.gov/news/press-release/2022-149>.

<sup>35</sup> Steven Miller, CBES, SEC Requires Public Companies to Disclose Pay-Versus-Performance Measures, SHRM (Sept. 2, 2022), <https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/sec-requires-public-companies-to-disclose-pay-versus-performance-measures.aspx> (quoting Brennan Rittenhouse, a managing director with consulting firm A&M Tax and LLC in Denver).

<sup>36</sup> See Executive Compensation, 17 C.F.R. § 229 (Item 402(b)) (“Compensation discussion and analysis.”), available at <https://www.law.cornell.edu/cfr/text/17/229.402>.



providing a quantitative reconciliation of those metrics to the most directly comparable GAAP financial measures.”<sup>37</sup>

### Non-GAAP Financial Measures

CII reiterates a request it first made in 2019 that the Commission add a new project to the Agenda to require disclosure of a quantitative reconciliation to GAAP of non-GAAP metrics used to determine executive compensation.<sup>38</sup> As described on CII’s website and generally reflected in our membership-approved corporate governance policies:<sup>39</sup>

CII is also pressing the SEC to close a loophole that permits the use of non-GAAP earnings in the Compensation, Discussion & Analysis (CD&A) section of a company’s proxy statement. 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. Yet an anomaly exists in that the existing SEC rules currently do not apply to the **target measures for compensation** contained in the CD&A, which is the important source of information investors use to evaluate executive compensation. Investors often struggle to make sense of how companies assess performance in approving large compensation packages. 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.<sup>40</sup>

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<sup>37</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 3; *see* Pay Versus Performance at 100 (“Because the disclosure required by the final rules is intended, among other things, to supplement the CD&A, we believe it is appropriate to treat non-GAAP financial measures provided under Item 402(v) of Regulation S-K consistently with the existing CD&A provisions [and] [a]s a result, the final rules specify that disclosure of a measure that is not a financial measure under generally accepted accounting principles will not be subject to Regulation G and Item 10(e) of Regulation S-K; however, disclosure must be provided as to how the number is calculated from the registrant’s audited financial statements.”).

<sup>38</sup> *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](https://www.cii.org/files/issues_and_advocacy/correspondence/2019/20190426%20CII%20Petition%20revised%20on%20non-GAAP%20financials%20in%20proxy%20statement%20CDAs.pdf) (“The Council of Institutional Investors respectfully submits this petition to the Securities and Exchange Commission (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 (CD&A) 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”).

<sup>39</sup> *See* Council of Institutional Investors, Corporate Governance Policies, § 5.5c Performance Based Compensation (“Performance-based compensation plans are a major source of today’s complexity and confusion in executive pay [and] [m]etrics for performance and performance goals can be numerous and wide-ranging.”).

<sup>40</sup> Council of Institutional Investors, CII Advocacy Priorities, Corporate Disclosure.

We note that it is estimated that over 95% of S&P 500 companies disclose a customized version of earnings that is not in accordance with GAAP.<sup>41</sup> These non-GAAP financial measures often exclude costs such as “[s]tock option expenses, write-offs [of] acquired intangibles, and restructuring charges.”<sup>42</sup> Some companies and some investors believe these exclusions are “not important for understanding the future value of the company.”<sup>43</sup>

The onset of Covid-19 appears to have further increased the use of non-GAAP financial measures, and perhaps more significantly, increased the gap between GAAP earnings and non-GAAP earnings.<sup>44</sup> As one legal expert observed last year:

[I]n the sample group [of earnings releases for 2020 issued by companies in the S&P 500 that reported both GAAP and non-GAAP earnings], non-GAAP net income exceeded GAAP net income by \$132.3 billion—more than double the total GAAP net income of \$130.7 billion. By comparison, a 2019 op-ed co-authored by former SEC Commissioner Robert Jackson cited research showing that firms in the S&P 500 announced adjusted earnings that were, on average, 23% higher than GAAP earnings and pointed to 36 companies in the S&P 500 that, in 2015, announced non-GAAP earnings more than 100% higher than the GAAP equivalent, and 57 more companies that reported non-GAAP earnings that were 50% to 100% higher than GAAP.<sup>45</sup>

Thus, while non-GAAP financial measures may be useful in understanding a company’s performance, they also may be misused to “opportunistically report higher profits.”<sup>46</sup> And other research has indicated that non-GAAP metrics determined a significant percentage of CEO’s annual cash bonuses, long-term stock awards, or both.<sup>47</sup>

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<sup>41</sup> See Vijay Govindarajan et al., Finance & Accounting, Mind the GAAP, Harv. Bus. Rev. (May 4, 2021), <https://hbr.org/2021/05/mind-the-gaap> (“95% of S&P 500 companies report both GAAP and non-GAAP earnings, showing its wide prevalence”).

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> See Cydney Posner, Is There a Resurgence in the Use of Non-GAAP Financial Measures?, Cooley PubCo (May 17, 2021), <https://cooleypubco.com/2021/05/17/resurgence-non-gaap-financial-measures> (“with the onset of COVID-19, there seems to have been something of a resurgence in the use of non-GAAP measures”).

<sup>45</sup> *Id.*

<sup>46</sup> Vijay Govindarajan et al., Finance & Accounting, Mind the GAAP, Harv. Bus. Rev.

<sup>47</sup> 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.”).



CII believes that the CD&A is the most important source of information used by investors in evaluating executive compensation.<sup>48</sup> Investors often struggle to make sense of how companies assess performance when approving large compensation packages.<sup>49</sup>

CII also believes 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.<sup>50</sup> The CD&A also informs investors’ understanding of a corporation’s governance more generally, and in voting on the election of its directors.<sup>51</sup>

Some might argue that the rulemaking envisioned by our 2019 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, 2021, and 2022 proxy statements of the seven companies we highlighted in the 2019 petition as examples of companies in need of better non-GAAP disclosure: Abbott Laboratories, Advanced Micro Devices, Altice USA, Cisco Systems, Cogent Communications Holdings, Oracle Corporation, and Revlon.<sup>52</sup> Based on our review, it does not appear that any of the companies have to-date provided a quantitative Non-GAAP to GAAP reconciliation or even a hyperlink to a Non-GAAP to GAAP quantitative reconciliation in their 2020, 2021, or 2022 CD&A.<sup>53</sup>

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<sup>48</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 10 (Apr. 22, 2021), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2021/April%202021%20SEC%20Reg%20Flex%20Letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/April%202021%20SEC%20Reg%20Flex%20Letter%20(final).pdf) (“The CD&A is the most important source of information used by investors in evaluating executive compensation.”).

<sup>49</sup> See *id.* (“Investors often struggle to make sense of how companies assess performance in approving large compensation packages.”).

<sup>50</sup> See *id.*

<sup>51</sup> See *id.*

<sup>52</sup> 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.

<sup>53</sup> See Abbott Laboratories, Schedule 14A at 35 (Mar. 18, 2022), <https://sec.report/Document/0001206774-22-000778/> (various adjusted measures); Advance Micro Devices, Inc., Schedule 14A at 57 (Mar. 31, 2022), <https://ir.amd.com/sec-filings/filter/proxy-filings/content/0001193125-22-091792/0001193125-22-091792.pdf> (adjusted non-GAAP net income and adjusted free cash flow); Altice USA, Inc., Schedule 14A at 14-16 (Apr. 29, 2022), <https://d18rn0p25nwr6d.cloudfront.net/CIK-0001702780/5f1ff5e1-64be-4d60-b0e5-fb7ea08cacaef.pdf> (adjusted EBITDA & adjusted EBITDA CapEx); Cogent Communications Holdings, Inc., Schedule 14A at 27 (Mar. 14, 2022), [https://www.cogentco.com/files/docs/about\\_cogent/investor\\_relations/reports/proxy\\_statement\\_2022.pdf](https://www.cogentco.com/files/docs/about_cogent/investor_relations/reports/proxy_statement_2022.pdf) (“adjusted EBITDA” (as defined in the Company’s earnings releases)); Revlon, Inc., Schedule 14A at 20 (Apr. 21, 2022), <https://sec.report/Document/0001140361-22-015295/> (adjusted EBITD); 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); Altice USA, Inc., Schedule 14A at 16-17 (Apr. 29, 2021), [https://www.sec.gov/Archives/edgar/data/1702780/000162828021008291/a2021proxystatement.htm#idf1a5efed63a409097f239df52ce09ef\\_160](https://www.sec.gov/Archives/edgar/data/1702780/000162828021008291/a2021proxystatement.htm#idf1a5efed63a409097f239df52ce09ef_160) (adjusted EBITDA); Cisco Systems, Inc., Schedule 14A at 25 (Oct. 22, 2021), [https://www.sec.gov/Archives/edgar/data/858877/000119312521306708/d174342ddef14a.htm#toc174342\\_22](https://www.sec.gov/Archives/edgar/data/858877/000119312521306708/d174342ddef14a.htm#toc174342_22) (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](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 34 (Sept. 24, 2021),

CII believes it is imperative that the SEC propose a rule to require, at a minimum, that companies include a hyperlink to a GAAP reconciliation for any non-GAAP pay targets contained in their CD&A.<sup>54</sup>

### Rule 10b5-1 Trading Plans

CII has long advocated for SEC action to improve to Rule 10b5-1<sup>55</sup> and close the loopholes that invite plan abuse.<sup>56</sup> As described on CII's website and generally reflected in our membership-approved corporate governance policies:<sup>57</sup>

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

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[https://www.sec.gov/Archives/edgar/data/1341439/000119312521282422/d162163ddef14a.htm#toc162163\\_25](https://www.sec.gov/Archives/edgar/data/1341439/000119312521282422/d162163ddef14a.htm#toc162163_25) (“non-GAAP pre-tax profit”, “non-GAAP operating income”); Revlon, Inc., Schedule 14A at 21-22 (Apr. 20, 2021), [https://www.sec.gov/Archives/edgar/data/0000887921/000114036121013412/nc10020840x1\\_def14a.htm](https://www.sec.gov/Archives/edgar/data/0000887921/000114036121013412/nc10020840x1_def14a.htm) (adjusted EBITDA and free cash flow); 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 (June 10, 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](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), <https://www.sec.gov/Archives/edgar/data/0001158324/000104746920001415/a2240954zdef14a.htm> (“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 at 22-23, 25-32 (Apr. 22, 2020), <https://sec.report/Document/0001140361-20-009411/> (includes no specific description of GAAP or non-GAAP targets).

<sup>54</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 11 (“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.”).

<sup>55</sup> See Trading “on the basis of” material nonpublic information in insider trading cases, 17 C.F.R. § 240.10b5-1 (2000), available at <https://www.law.cornell.edu/cfr/text/17/240.10b5-1>

<sup>56</sup> See Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Elissa B. Walter, Chairman, U.S. Securities and Exchange Commission 3 (Dec. 28, 2012), <https://www.sec.gov/rules/petitions/2013/petn4-658.pdf> (“More specifically, we would respectfully request that the Securities and Exchange Commission . . . consider pursuing . . . amendments to Rule 10b5-1 that would require Rule 10b5-1 plans to adopt the following protocols and guidelines”).

<sup>57</sup> See Council of Institutional Investors, Policies On Other Issues, Statement on Stock Sales by Insiders [https://www.cii.org/policies\\_other\\_issues#insider\\_trading](https://www.cii.org/policies_other_issues#insider_trading) (“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; and ineligible for substantive modification [and] [p]articipants should not be party to concurrently active 10b5-1 plans, and companies should avoid frequently cancelling and adopting new plans [and] [b]oards should periodically monitor plan transactions and adopt written policies covering plan practices, including how plans may be used in the context of guidelines or requirements on equity hedging, holding and ownership; and suspend trading under such plans upon internal awareness of an M&A transaction or tender offer involving the company.”).

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 [<sup>58</sup>] and we have urged the commission repeatedly to close the loopholes that invite plan abuse.

In December 2021, SEC commissioners unanimously approved putting out for comment proposed rules to tighten the loopholes and enhance transparency of executive trading plans in company stock. The proposed rule referenced CII advocacy multiple times.<sup>59</sup>

In March CII submitted a comment letter in response to the proposed rule (March Letter).<sup>60</sup> The March Letter “strongly supports the Proposed Rule”<sup>61</sup> and recommended the following modest improvements:

- “revising the Proposed Rule’s instruction providing guidance about the retention of the certification to require the issuer, either instead of, or in addition to the director or officer, to retain the certification”,<sup>62</sup> and
- revis[ing] to require, consistent with the September 2021 recommendation of the SEC’s Investment Advisory Committee . . . that the disclosures be made on Form 8-K rather than on Form 10-Q”<sup>63</sup>

Other institutional and retail investors and investor groups generally agreed with CII and applauded the proposed rules.<sup>64</sup>

More evidence of the need for the final rule was provided by a July *Wall Street Journal* analysis of 75,000 trades by corporate insiders who executed transactions under Rule 10b5-1

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<sup>58</sup> See Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Elissa B. Walter, Chairman, U.S. Securities and Exchange Commission at 3.

<sup>59</sup> Council of Institutional Investors, CII Advocacy Priorities, Corporate Disclosure.

<sup>60</sup> See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa A. Countryman, Secretary, Securities and Exchange Commission (Mar. 24, 2022), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2022/March%2024%202022%20Rule%2010b5-1%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/March%2024%202022%20Rule%2010b5-1%20(final).pdf).

<sup>61</sup> *Id.* at 5.

<sup>62</sup> *Id.* at 6.

<sup>63</sup> *Id.*

<sup>64</sup> See Bryan Cave Leighton Paisner, How narrow will the 10b5-1 Safe Harbor become? Business community calls for major changes to SEC’s proposals, JDSUPRA (May 13, 2022), [HTTPS://WWW.JDSUPRA.COM/LEGALNEWS/HOW-NARROW-WILL-THE-10B5-1-SAFE-HARBOR-9397428/](https://www.jdsupra.com/legalnews/how-narrow-will-the-10b5-1-safe-harbor-9397428/) (“institutional and retail investors and investor groups, such as [Council of Institutional Investors](#), [NYC Office of Comptroller](#) and [Colorado PERA](#), as well as groups such as [NASAA](#), [AFL-CIO](#) and [Public Citizen](#), applauded the proposals and generally refrained from suggesting any changes, other than a few recommendations for disclosure of adoption or termination of plans on Form 8-K instead of Form 10-Q.”).

plans.<sup>65</sup> The analysis indicated that there were a significant number of insiders making opportunistic use of their Rule 10b5-1 plans in conflict with the intent of the rule.<sup>66</sup>

For all the above reasons we respectfully request that the Commission prioritize the issuance of a final rule on Rule 10b5-1 trading plans.

### 3. Market Systems & Structure

We include under this heading our appreciation for the Commission’s “COMPLETED ACTION[]”<sup>67</sup> on “Universal Proxy”<sup>68</sup> by issuing a final rule last December,<sup>69</sup> and our request that the SEC give a higher priority to the Agenda project on “Proxy Process Amendments.”<sup>70</sup> We would also include under this heading our request that the Commission issue a proposed rule in connection with the Agenda project on “Equity Market Structure Modernization.”<sup>71</sup>

#### Universal Proxy

As indicated, CII is very pleased with the SEC’s issuance of a final rule on Universal Proxy. As you are aware, we had long advocated for universal proxies in contested elections for seats on public company boards.<sup>72</sup>

The final rule is generally consistent with CII’s membership-approved policy which states that “to facilitate the shareholder voting franchise, the opposing sides engaged in a contested election should utilize a proxy card naming all management-nominees and all shareholder-proponent nominees, providing every nominee equal prominence on the proxy card.”<sup>73</sup> The following analysis by EY describes some of the many investor benefits resulting from the new rule:

Until now, most shareholders have had to adopt an “our card vs. their card” mentality rather than being focused on the individual nominees. This has left many shareholders feeling constrained in their ability to support moderate changes to the board. Now these shareholders will have more options to express their opinion on the optimal makeup of the board. When faced with more candidates for election

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<sup>65</sup> See Tom McGinty & Mark Maremont, CEO Stock Sales Raise Questions About Insider Trading, Wall St. J. (June 29, 2022) (on file with CII).

<sup>66</sup> See *id.* (finding that 20 percent of insiders sold shares within 60 trading days of adopting a Rule 10b5-1 plan and that those traders collectively earned \$500 million more in profits than they would have if they sold stock three months later and that these sales preceded a decrease in share price more often than when insiders waited to trade).

<sup>67</sup> 87 Fed. Reg. at 48,425.

<sup>68</sup> *Id.*

<sup>69</sup> See Universal Proxy, Securities Act Release No. 93,596, Investment Company Act Release No. 34,419, 86 Fed. Reg. 68,330 (Dec 1, 2021), <https://www.federalregister.gov/documents/2021/12/01/2021-25492/universal-proxy>.

<sup>70</sup> Agency Rule List - Spring 2022, Securities and Exchange Commission, Off. Info. & Reg. Aff., Off. Mgmt. & Budget (categorizing “Proxy Process Amendments” in “Long-Term Actions”).

<sup>71</sup> *Id.* (categorizing “Equity Market Structure Modernization” in the “Proposed Rule Stage”).

<sup>72</sup> See, e.g., Letter from Glenn Davis, Director of Research, Council of Institutional Investors to Ms. Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission (Jan. 8, 2014), <https://www.sec.gov/rules/petitions/2014/petn4-672.pdf> (“Petition for Rulemaking to Amend Section 14 of the Securities Exchange Act of 1934 to Facilitate the Use of Universal Proxy Cards in Contested Elections”).

<sup>73</sup> Council of Institutional Investors, Corporate Governance Policies, § 2.2, Director Elections.

than seats on the board, investors no longer must first decide if dissatisfaction rises to the level of pushing them to abandon the company card in order to effectuate changes to the board

....

The change will provide a more even playing field for those voting by proxy and give investors more options to express their view on who should be on the board[.]<sup>74</sup>

CII also commends the SEC staff for proactively issuing “Compliance and Disclosure Interpretations”<sup>75</sup> to “address questions that have arisen in connection with notice and proxy statement disclosure.”<sup>76</sup> We believe the guidance will enhance the effective implementation of the universal proxy rule.

### Proxy Process Amendments

As indicated, we are disappointed that the Commission’s project on “Proxy Process Amendments” continues to remain categorized under “Long-Term Actions” on the Agenda.<sup>77</sup> Since the Universal Proxy rule has been finalized and is now being implemented, we believe the SEC should prioritize as a next step improving proxy plumbing by addressing end-to-end vote confirmation.<sup>78</sup> As described on CII’s website:

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<sup>74</sup> David A. Hunker, Universal Proxies: What boards should know and how companies can prepare, EY (May 17, 2022), [https://www.ey.com/en\\_us/board-matters/universal-proxies-what-boards-should-know-and-how-companies-can-prepare](https://www.ey.com/en_us/board-matters/universal-proxies-what-boards-should-know-and-how-companies-can-prepare); see Martin Lipton, Wachtell, Lipton, Rosen & Katz, Dealing with Activist Hedge Funds and Other Activist Investors, Harv. L. Sch. F. on Corp. Governance (posted Sept. 2, 2022), <https://corpgov.law.harvard.edu/2022/09/02/dealing-with-activist-hedge-funds-and-other-activist-investors-5/> (“The indisputable fact about the universal proxy card (UPC) is that it is a far superior way for shareholders to exercise their voting franchise than the two-card system that has dominated proxy contests for decades.”).

<sup>75</sup> U.S. Securities and Exchange Commission, Proxy Rules and Schedules 14A/14C (Last Update: Aug. 25, 2022), <https://www.sec.gov/corpfin/proxy-rules-schedules-14a-14c-cdi>.

<sup>76</sup> Cydney S. Posner, Corp Fin issues new CDIs on universal proxy, Cooley PubCo (Aug. 30, 2022), [https://cooleypubco.com/2022/08/30/new-cdis-universal-proxy/?utm\\_source=Mondaq&utm\\_medium=syndication&utm\\_campaign=LinkedIn-integration](https://cooleypubco.com/2022/08/30/new-cdis-universal-proxy/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration).

<sup>77</sup> Agency Rule List - Spring 2022, Securities and Exchange Commission, Off. Info. & Reg. Aff., Off. Mgmt. & Budget (categorizing “Proxy Process Amendments” in “Long-Term Actions”).

<sup>78</sup> See Commissioner Allison Herren Lee, Statement, Protecting the Independence of the Proxy Voting Process: Statement on Amendments Governing Proxy Voting Advice (July 13, 2022), <https://www.sec.gov/news/statement/lee-statement-amendments-governing-proxy-voting-advice-071322> (“We know . . . that many shareholders are unable to confirm their shares are voted in accordance with their instructions, a concern that could be addressed through required end-to-end vote confirmations”); 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), <https://www.marketwatch.com/story/new-sec-chair-needs-to-tackle-these-5-big-issues-so-the-government-can-do-a-better-job-for-investors-2020-12-17> (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, Cooley PubCo, JDSUPRA (Feb. 3, 2021), <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).



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 and for a decade, a mechanism for confirming that votes were counted as intended has eluded market participants.

But in December 2021, a working group of banks, broker-dealers, public companies, tabulators, transfer agents and others in the proxy service community agreed to provide vote confirmation for 2022 annual shareholder meetings of Fortune 500 companies. In addition, Broadridge Financial Solutions, Computershare, EQ and Mediant have agreed to provide vote confirmation for all annual meetings for which they tabulate votes. In total, this means vote confirmation will be possible for more than 2,000 U.S. annual meetings in 2022.

CII co-chaired the working group with the Society for Corporate Governance and will monitor the efficacy of this new vote confirmation process, based on feedback from investor members.<sup>79</sup>

The voting confirmation process that the working group put in place for shareholder meetings this year requires institutional investors to go to the tabulator's website and enter a 12 or 16-digit confirmation number, depending on the tabulator, from at least one ballot for each company meeting. Investors that use multiple custodians have to manually enter the information from at least one ballot for each company meeting for each custodian. The process does not "live" on the Institutional Shareholder Services and Glass Lewis voting platforms that most institutional investors use to vote so it is a big ask to get shareholders to try it.

CII persuaded several asset owner and asset manager members to spot-check votes. But it's so cumbersome that no one has used it to test for inaccuracies at more than 40 meetings. A few members have agreed to run it for 1,000 meetings that occurred this year, but they have not yet started the process. The fact that this process cannot be used to confirm votes in contests—where confirmation really matters—has been a disappointment to investors and a disincentive to test it.

Proxy intermediaries participating in the working group have said they will work toward a more automated process—for routine votes. But vote confirmation for contests appears to be a long way off—in part because that requires cooperation among tabulators and other intermediaries for both companies and dissidents.

Because most votes—for director or other ballot issues—are not close, companies have less of an incentive to fix the system on their own. And intermediaries are a) competitors and b) have sunk costs in software systems that do not easily communicate with each other.

CII believes there is a role for the SEC to move vote confirmation into the 21<sup>st</sup> century by issuing a proposed rule. More specifically, the SEC could require end-to-end vote confirmations to end-

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<sup>79</sup> Council of Institutional Investors, CII Advocacy Priorities, Market Systems & Structure (2022), [https://www.cii.org/market\\_systems\\_structure](https://www.cii.org/market_systems_structure).



users, potentially with a phase-in approach starting with the largest companies. The proposed rule could require, as former SEC Commissioner Allison Herren Lee has suggested, “all participants in the voting chain to grant to issuers, or their transfer agents or vote tabulators, access to certain information relating to voting records, for the limited purpose of enabling a shareholder or securities intermediary to confirm how a particular shareholder’s shares were voted.”<sup>80</sup> We believe proposing such a rule would provide a basis for continuously uncovering and remediating flaws in the basic “plumbing” of the system.

### Equity Market Structure Modernization

CII respectfully requests that the Commission issue a proposed rule in connection with its project on “Equity Market Structure Modernization”<sup>81</sup> As described on CII’s website:

CII members and other institutional investors depend on effective market regulation. Long before the creation of a securities market regulator in the United States, stock exchanges were the leading guardians of investor protection. But that is no longer the case. The exchanges have morphed from nonprofit gatekeepers to for-profit entities that compete for primary listings and seek to monetize trading data that is critical to high-functioning capital markets

....

For-profit pressure has . . . intensified arrangements with brokers to attract order flow. CII supported an SEC pilot program to shed light on the degree to which certain rebates exchanges pay to brokers encourage them to send trade orders to exchanges that pay favorable rebates rather than to those that offer the best results for investors. A court later invalidated the pilot as exceeding the SEC’s authority.<sup>82</sup>

In addition, CII’s long-standing membership-approved corporate governance policies which are relevant to equity market structure states:

The most important voice in discussions of . . . commission levels and directed brokerage belongs to us, as institutional investors. Commissions are an asset of the plan, and as plan sponsors and trustees it is our right and responsibility to decide how they are managed. We have the power to assert our authority in these matters through our contractual arrangements with money managers and brokers. We also

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<sup>80</sup> Commissioner Allison Herren Lee, Protecting the Independence of the Proxy Voting Process: Statement on Amendments Governing Proxy Voting Advice n.6. (July 13, 2022), <https://www.sec.gov/news/statement/lee-statement-amendments-governing-proxy-voting-advice-071322> ; see Commissioner Allison Herren Lee, Speech at the 2021 ICI Mutual Funds and Investment Management Conference: Every Vote Counts: The Importance of Fund Voting and Disclosure (Mar. 17, 2022), <https://www.sec.gov/news/speech/lee-every-vote-counts> ( “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 permissioned blockchain to record beneficial ownership and execute votes.”).

<sup>81</sup> Agency Rule List - Spring 2022, Securities and Exchange Commission, Off. Info. & Reg. Aff., Off. Mgmt. & Budget (categorizing “Equity Market Structure Modernization” in the “Proposed Rule Stage”).

<sup>82</sup> Council of Institutional Investors, CII Advocacy Priorities, Market Systems & Structure.

have the broader duty to communicate the interests and desires of the institutional investor community to regulators, to the public and to the industry regarding trading practices and commissions.

Like any other expense of the plan, trading costs need to be managed to minimize the cost and ensure that maximum value is received. But current brokerage industry practices . . . make it difficult to break out the exact costs of services (for trade execution, research or other things), may be antithetical to the fiduciary obligation of obtaining best execution, and hold too much potential for conflicts of interest and abuses.

. . . .

Clarity and transparency of disclosure of all money management and brokerage arrangements is essential, and it is up to plan sponsors to require it. Simple reliance on brokers, money managers and consultants for volunteered information is insufficient to discharge the obligations of plan fiduciaries. Plan sponsors should require regular reports and affirmative representations that fiduciaries are pursuing best execution in their trading practices.

To the extent that any money manager or plan sponsor is engaged in . . . directing brokerage to obtain commission recapture, it is the duty of fiduciaries to ensure that all such practices are engaged in for the exclusive benefit of the plan and its members.<sup>83</sup>

Generally consistent with our policy, we believe the SEC should issue a proposed rule that includes provisions addressing two issues of interest to institutional investors: (1) best execution and (2) stock exchange rebates.

*(1) Best Execution*

As SEC Chair Gensler recently remarked:

Right now, while the Financial Industry Regulatory Authority (FINRA) . . . have rules on best execution, the SEC does not. These FINRA . . . rules require broker-dealers to exercise reasonable diligence to execute customer orders in the best market so that their customers receive the most favorable prices under prevailing market conditions.

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<sup>83</sup> Council of Institutional Investors, CII Policies, Policies on Other Issues, Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture (adopted Mar. 31, 1998), [https://www.cii.org/policies\\_other\\_issues#principles\\_trading\\_commission\\_softdollar](https://www.cii.org/policies_other_issues#principles_trading_commission_softdollar).

I think investors might benefit if the SEC considered proposing its own best execution rule.<sup>84</sup>

CII generally agrees with SEC Chair Gensler that investors would benefit if the SEC proposes its own best execution rule. It is our understanding that the FINRA best execution rule<sup>85</sup> has been weakened so that firms that send orders to other executing firms are allowed to conduct a periodic review of the execution quality they get from those firms on an average basis.<sup>86</sup> Wholesalers handling retail orders evaluate themselves based on the average level of price improvement they obtain for millions of orders, not whether each order is receiving the best price available at the time.

CII believes an SEC proposal imposing an “order-by-order” best execution requirement on all brokers for all types of orders would likely help to enforce the best execution standard in a more consistent way for all market participants, including institutional investors. We, therefore, respectfully request that the SEC consider proposing the creation of a new best execution rule with provisions that provide the SEC the ability to enforce a standard requiring that each investor is entitled to receive the best execution of its orders on an order-by-order basis.

## *(2) Stock Exchange Rebates*

In SEC Chair Gensler’s recent remarks about best execution, he also stated:

Exchange rebates also may present conflicts.

Exchanges give rebates to traders. High-volume traders benefit more from these arrangements, and retail investors don’t directly benefit from those rebates. Just as payment for order flow presents a conflict of interest in the routing of marketable retail orders, exchange rebates may present a similar conflict in the routing of customer limit orders.

Therefore, I’ve asked staff to make recommendations around how we can mitigate conflicts with respect to payment for order flow and rebates.

One thing I’ve asked them to consider is whether exchange fees — what somebody pays to access a quotation on an exchange — and rebates should be more

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<sup>84</sup> Chair Gary Gensler, “Market Structure and the Retail Investor:” Remarks Before the Piper Sandler Global Exchange Conference (June 8, 2022) (footnote omitted), <https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822>.

<sup>85</sup> See FINRA, Rules & Guidance, 5310. Best Execution and Interpositioning (May 9, 2014), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310>.

<sup>86</sup> Nicholas J. Losurdo & Christopher Grobbel, Article, United States: SEC Publishes Spring Rulemaking Agenda: Torrid Pace Continues; Crypto Framework Noticeably Absent, Goodwin (July 1, 2022), available at <https://www.mondaq.com/unitedstates/fin-tech/1207722/sec-publishes-spring-rulemaking-agenda-torrid-pace-continues-crypto-framework-noticeably-absent> (opining that “an SEC best execution rule could help further drive efficiencies across markets”).

transparent, so that investors can understand these amounts at the time of trade execution.<sup>87</sup>

It is our understanding that most of the rebates paid by stock exchanges are paid out based on total market-wide volume numbers, determined over some period of time (for example, if a firm trades on the exchange 1.5% of the consolidated average daily trading volume across all equity markets during a month, the firm will receive a rebate payment of XX cents per share). This means that when a broker sends an order for a customer to the exchange, it won't know what its payment is, or receive its total rebate payment, until the end of the month and it won't be possible to allocate a specific benefit to the orders sent for that customer compared to other orders it sends. We note, however, that the conflict referenced by SEC Chair Gensler is just as acute – the broker will still be motivated to send orders where they can receive a high rebate payment, not where they will get the best result for the customer.

As an alternative, CII would generally support having stock exchange rebates paid in such a way that the per trade rebate benefit would be known at the time of each trade. More specifically, we would respectfully request that the SEC consider proposing that stock exchange rebate fee schedules be structured so that the total rebate benefit received is more transparent and investors can understand the amount of rebate relating to their order at the time of trade execution.<sup>88</sup> In this way, and generally consistent with our policies, investors could seek to recover the rebates that were received related to their trades, and this greater transparency could lessen the conflicts that SEC Chair Gensler has identified in the current rebate system.

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Thank you for consideration of CII's views. If we can answer any questions or provide additional information on the Agenda or this letter, please do not hesitate to contact me.

Sincerely,



Jeffrey P. Mahoney  
General Counsel

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<sup>87</sup> Chair Gary Gensler, "Market Structure and the Retail Investor:" Remarks Before the Piper Sandler Global Exchange Conference.

<sup>88</sup> See, e.g., Ivy Schmerken,, Insights, Plans for Equity Market Structure Revamp Stimulate Debate, FlexTrade (July 26, 2022), <https://flextrade.com/equity-market-structure-revamp-stimulates-debate/> (quoting Joe Wald, managing director at BMO Capital Markets that there are "exchange rebates that are not transparent today [and] . . . they should be disclosed on an order-by-order basis."").