Council of Institutional Investors®

Testimony of

Ken Bertsch

Executive Director

Council of Institutional Investors

Before the

Committee on Financial Services

United States House of Representatives

April 28, 2017

Hearing on Financial CHOICE Act

Dear Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

Good morning. I am Ken Bertsch, Executive Director, of the Council of Institutional Investors (CII or Council). The Council is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. We also have associate members that include a range of asset managers with more than $20 trillion in assets under management.

I appreciate the opportunity to appear before you today on behalf of the Council. I respectfully request that the full text of my testimony, including the attached Council's April 24th letter to the Chairman and the Ranking Member be entered into the public record.

Members of the Council include funds responsible for safeguarding assets used to fund the retirement benefits of millions throughout the U.S. They have a significant commitment to the U.S. capital markets, and they are long-term, patient investors due in part to the heavy commitment of most to passive investment strategies. As a result, issues relating to the U.S. financial regulatory system, particularly issues involving corporate governance and shareowner rights, are of great interest to our members.

We believe that in its current form, the Financial CHOICE Act, if enacted, would weaken critical shareholder rights that investors need to hold management and boards of public companies accountable, and that foster trust in the integrity of the U.S. capital markets.

Americans suffered enormously from Enron and other corporate scandals of 15 years ago, and even more from the failures of oversight that contributed to the 2008 financial crisis. Many Americans lost jobs, homes and retirement savings.

The bill would threaten prudent safeguards for oversight of companies and markets, including some sensible reforms made in the wake of Enron and the financial crisis to close critical gaps in regulation. Our April 24th letter to the committee chair and ranking member outlines troubling ways that the bill threatens fundamental shareholder protections. In particular, let me highlight five areas of concern.

First, the bill would set prohibitively costly hurdles on shareholder proposals. Provisions of the bill would require a shareholder wishing to put a proposal on a company's annual meeting ballot to own at least 1% of the stock for three years, compared to the current requirement of $2,000 worth of stock for one year. That dramatic change would, for example, raise the ownership threshold to file a single shareholder proposal to $7.5 billion at Apple, $3.4 billion at Exxon Mobil and $2.6 billion at Wells Fargo.

Second, the bill would roll back curbs on abusive pay practices. Under the provisions of the bill, shareholders would get an advisory vote on executive compensation only when there is an undefined "material" change in CEO pay. Most U.S. public companies currently offer investors say-on-pay votes annually. The bill would also limit clawbacks of unearned executive compensation.

Third, the bill would restrict the right of shareholders to vote for directors in contested elections for board seats**.** The provisions of the bill would bar the use of "universal proxy" cards that give investors freedom of choice to vote for the specific combination of director nominees they believe best serves their interests.

Fourth, the bill would create an intrusive new regulatory scheme for proxy advisors that provide shareholders with independent research they need to vote responsibly**.** The provisions of the bill would drive up costs for investors, potentially compromise the independence of advisors and impinge on their ability to provide honest advice to clients, create barriers to entry and even drive some proxy advisors out of business.

And finally, the bill would **s**hackle the Securities and Exchange Commission (SEC) with excessive and unworkable cost-benefit analysis requirements. Those provisions would severely undercut the SEC's ability to fulfill its mission to protect investors, police markets and foster capital formation.

Notwithstanding our strong opposition to many of the provisions in the bill, we stand ready to work cooperatively with this Committee, my fellow panelists and other interested parties to develop meaningful improvements in the U.S. financial regulatory system that best serve the needs of investors, companies and the capital markets.

Thank you, Mr. Chairman and Ranking Member Waters for inviting me to participate at this hearing. I look forward to the opportunity to respond to any questions.

ATTACHMENT

Via Hand Delivery

April 24, 2017

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Hearing on the Financial CHOICE Act of 2017[1]

I am writing on behalf of the Council of Institutional Investors (CII), a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $20 trillion in assets under management.[2]

The purpose of this letter is to thank you for holding a hearing on the April 19 discussion draft of the Financial CHOICE Act of 2017 (Act) and to share with you a summary of our initial views. We have organized our comments under three general subject headings: (1) Protect Fundamental Shareholder Rights; (2) Promote Effective Disclosure and Reliable Financial Reporting; and (3) Safeguard the Independence of the U.S. Securities and Exchange Commission (SEC or the Commission).

We would respectfully request that this letter be included in the hearing record.

---

[1] Financial CHOICE Act of 2017, H.R. ____, 115th Congress (discussion draft Apr. 19, 2017), *available at* https://financialservices.house.gov/uploadedfiles/choice_2.0_discussion_draft.pdf.
[2] For more information about the Council of Institutional Investors (CII) and our members, please visit CII's website at http://www.cii.org/about_us.

1. Protect Fundamental Shareholder Rights

Shareholder Proposals

CII opposes Section 844 of the Act because it would dramatically restrict the ability of shareowners to file proposals on important governance issues.

CII and its members have a deep interest in ensuring that Rule 14a-8,[3] the federal rule that governs shareholder proposals, is fair and workable for shareowners and companies.[4] The rule provides an orderly means to mediate differences between managers and owners, and we are mindful that many positive advances in U.S. corporate governance practices simply would not have occurred without a robust shareowner proposal process in place. For example:

- Shareholder proposals were the impetus behind the now standard practice—currently mandated by major U.S. stock exchanges' listing standards—that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance.

- In 1987, an average of 16% of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81% level of support on average. Ten years ago, less than 40% of S&P 500 companies held annual director elections compared to more than two thirds of these companies today.

- Electing directors in uncontested elections by majority (rather than plurality) vote was considered a radical idea a decade ago when shareholders pressed for it in proposals they filed with numerous companies. Today, 90% of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority voting proposals.

- A proposal that built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years is the request for proxy access. Resolutions filed by the New York City Comptroller to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, at least 400 companies have adopted proxy access bylaws.[5]

---

[3] 17 CFR 240.14a-8 - Shareholder proposals, Cornell U. L. School, LII, *available at* https://www.law.cornell.edu/cfr/text/17/240.14a-8 (last viewed Apr. 23, 2017).
[4] *See, e.g.*, Examining the U.S. Proxy Voting System: Is it Working for Everyone, Corporate Governance Roundtable, Hosted by Rep. Scott Garrett, 114th Cong (Nov. 16, 2015) (Statement of Amy Borrus, Interim Executive Director, Council of Institutional Investors), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/11_16_15_cii_Rep%20_Garrett_roundtable_submission_amy_borrus.pdf.
[5] *See, e.g.,* Ceres Investor Network on Climate Risk and Sustainability, The Business Case for the Current SEC Shareholder Proposal Process 6 (Apr. 2017) (on file with CII).

Section 844 of the Act would radically increase the regulatory hurdles for shareholder proposals. Current rules set a minimum $2,000 ownership requirement.[6] More specifically, Section 844(b) of the Act would require any shareholder wishing to put a proposal on a public company ballot to own at least 1% of the company's stock for a minimum of three years.

Section 844(b) of the Act would require, for example, an investor at Wells Fargo to own approximately $2.6 billion in shares in order to file a single proposal. At Apple, the largest U.S. company by market capitalization, a shareholder would have to own more than $7 billion of stock to file a single proposal. Even our largest public pension fund members rarely hold 1% of a public company.[7] In fact, based on holdings as of December 30, 2016, the only shareholders with eligibility to propose resolutions at Apple would be BlackRock, Vanguard, State Street, FMR, Northern Trust, Bank of New York Mellon, Berkshire Hathaway and T. Rowe Price. To our knowledge, none of these investors has ever presented a shareholder proposal at an annual meeting.

In addition, current rules require a shareholder to re-file a proposal only if it has received at least 3% of the vote on its first submission, 6% on the second and 10% on the third. [8] Section 844(a) of the Act would raise those thresholds to 6%, 15% and 30%, respectively.[9] Those hurdles could also knock out many important governance proposals that, if adopted, could enhance long-term shareowner value. The percentages of proposals since 2000 that are estimated to have fallen below the proposed thresholds are 13.3%, 31.5%, and 50.1%, respectively.

We agree with Anne Sheehan, director of corporate governance at the California State Teachers' Retirement System, the second largest U.S. public pension fund, and a CII member, that the provisions of Section 844 of the Act "would shut down the shareholder proposal process completely."[10] Shutting down shareholder proposals is likely to have unintended consequences, including shareowners more often availing themselves of the blunt instrument of votes against directors, and increased reliance on hedge fund activists to push for needed corporate changes.

Universal Proxies

CII opposes Section 845 of the Act because it appears intended to bar the SEC from issuing a final rule that would allow shareowners to freely vote for those board candidates they favor in a contested election.

---

[6] 17 CFR 240.14a-8(b) Question 2.

[7] *See, e.g.*, Letter from Jack Ehnes, Chief Executive Officer, California State Teachers' Retirement System, to The Honorable Maxine Waters, Ranking Member, House Committee on Financial Services 1 (Apr. 20, 2017) ("While 1% may sound like a small amount, even a large investor like the $200 billion CalSTRS fund does not own 1% of publicly traded companies.") (on file with CII).

[8] 17 CFR 240.14a-8(i)(12).

[9] Financial CHOICE Act of 2017, § 844(a).

[10] Andrea Vittorio, Shareholder Advocacy Tool Shut Down in Republican Plan., Bloomberg BNA's Corp. L. & Accountability Rep., Apr. 19, 2017, at 2, *available at* https://www.bna.com/shareholder-advocacy-tool-n57982086844/.

The problem that the SEC's October 2016 universal proxy proposal[11] would resolve is a problem that was clearly articulated by the SEC's Investor Advisory Committee in 2013.[12] Namely, investors are currently disenfranchised in a proxy contest, to the extent they vote by proxy, because they 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.[13]

That view is reflected in our membership approved policies for director elections which states:

> 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.[14]

Some opponents of universal proxy cards contend their use would encourage more proxy contests or favor dissidents. We are unaware of any compelling empirical evidence indicating that universal proxies would favor shareowner-proponent board nominees over company-nominees (or the reverse).[15] As concluded in a recent expert analysis of the SEC proposal by attorneys with Fried Frank Harris & Jacobson LLP: "In our view, the universal proxy card mandate, if adopted, would not significantly affect the outcome of proxy contests or activist situations."[16]

---

[11] Universal Proxies, Exchange Act Release No. 79,164, Investment Company Act Release No. 32,339 (proposed rule Oct. 26, 2016*), available at* https://www.sec.gov/rules/proposed/2016/34-79164.pdf.

[12] Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots 2 (adopted July 25, 2013) ("shareholders [currently] have no practical ability to 'split their tickets' and vote for a combination of shareholder nominees and management nominees), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf; *see* Letter from Ken Bertsch, Executive Director, Council of Institutional Investors, to Brent J. Fields, Secretary, Securities and Exchange Commission 3, 6-40 (Dec. 28, 2016) (Explaining in detail why the "proposal will facilitate the ability of shareholders to fully exercise their franchise by proxy by allowing them to vote for the combination of nominees of their choice"), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/12_28_16_comment_letter_SEC_universal_proxy.pdf; *see also* Carl Icahn, Statement Regarding SEC Proposal to Require Use of Universal Proxy Cards (Oct. 27, 2016) ("the introduction of the universal proxy card will eliminate needless voter confusion in contested elections, give shareholders greater freedom of choice, and hopefully end some of the gamesmanship employed by incumbent boards to keep shareholder-nominated directors out of the boardroom"), *available at* http://carlicahn.com/statement-regarding-sec-proposal-to-require-use-of-universal-proxy-cards/.

[13] *Id.*

[14] CII Policies, §2.2 Director Elections (updated Sept. 30, 2016), *available at* http://www.cii.org/corp_gov_policies.

[15] *See, e.g.*, Tatyana Shumsky, SEC Weighs Universal Proxy Vote Cards, Wall St. J., Feb. 19, 2016, at 1 (Quoting Michelle Anderson, associate director in the SEC's Division of Corporation Finance, that the universal proxy project is "'not about favoring the company of the dissident'"), *available at* http://blogs.wsj.com/cfo/2016/02/19/sec-weighs-universal-proxy-vote-cards/.

[16] Gail Weinstein et. al., Fried Frank Harris Shriver & Jacobson LLP, Expert Analysis, A Practical Assessment of the 'Universal Proxy Card' Plan, Law360 at 5 (Dec. 14, 2016) (emphasis removed), *available at* https://www.law360.com/articles/871184/a-practical-assessment-of-the-universal-proxy-card-plan.

We also agree with Keith F. Higgins, former SEC Director of Corporation Finance, who recently commented:

> What I haven't heard is a good answer to this simple question: *Why shouldn't a shareholder who votes by proxy have the same voting options as a shareholder who votes in person? Unless someone comes up with a good answer to that question, I think the Commission should move forward with the proposal*, although I note that a prohibition on doing so may be part of version 2.0 of the Financial CHOICE Act being considered by the House Financial Services Committee. Even though there are only a relatively small number of contested elections each year, *it is a glitch in the system of fair suffrage that should be fixed*.[17]

Say-on-Pay

CII opposes Section 843 of the Act because it would reduce the required frequency of shareholder advisory votes on executive compensation, commonly called say-on-pay votes.

The requirements of Section 951, "Shareholder Vote on Executive Compensation Disclosures," of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), as implemented by the SEC, are generally consistent with CII's membership-approved corporate governance policies.[18] Those policies state:

> All companies should provide annually for advisory shareowner votes on the compensation of senior executives.[19]

While the requirement provides for say-on-pay votes to be held annually, biennially, or triennially, to date over 90% of public companies have opted for annual votes consistent with our policy.[20] Voting trends, investor preferences and results from our member survey indicate that support for annual say-on-pay in 2017 will be at or above that level.[21]

An annual say-on-pay vote is critical to investors, in part, because it provides shareowners with the ability to communicate their views on the most recent payouts stemming from the policies used to administer executive compensation practices. Those payouts may change in unforeseeable and unexpected ways due to a policy's complexity, reliance on forward-looking factors and board discretion.

---

[17] Keith F. Higgins, Keynote Address at the Practicing Law Institute Corporate Governance – A Master Class 2 (Mar. 9, 2017) (emphasis added) (on file with CII).
[18] §5.2 Advisory Shareowner Votes on Executive Pay
[19] *Id.*
[20] CII, Say-On-Pay Frequency: A Fresh Look 1 (Dec. 2016), *available at* http://www.cii.org/files/publications/misc/12_22_16_SOP_Frequency_Report_Formatted.pdf
[21] *Id.*

It is now widely recognized that an annual vote on executive compensation has resulted in a number of ongoing improvements to the process in which corporate boards determine executive pay, including:

- Boards are actively and frequently reaching out to shareowners to solicit their concerns about, and their approval of, executive compensation plans;
- Boards are increasing the proportion of executive compensation linked to company performance, leading to potentially greater alignment between the two; and
- Boards are eliminating executive compensation perks such as club memberships that blur the line between personal and business expenses.[22]

Proxy Research

CII opposes Section 482 of the Act because it would establish an additional federal regulatory superstructure for proxy advisory firms that institutional investors, the primary customer of those firm's research services, do not want or need.

Proxy advisory firms play a vital and necessary role in assisting many pension funds and other institutional investors in carrying out their fiduciary duty to vote proxies. By law, pension fund fiduciaries have a duty to ensure that their proxies are voted in the best long-term interests of plan participants and beneficiaries. Many pension funds and other institutional investors contract with proxy advisory firms to obtain and review their research. But most large holders vote according to their own guidelines and policies.

Last September a letter co-signed by 30 CII members and other organizations expressed concerns about the Act's proxy advisory firm provisions.[23] Those provisions and our specific related concerns remain the following:

[22] *See, e.g.,* Paul Hodgson, Surprise Surprise: Say on Pay Appears to Be Working, Fortune.com, July 8, 2015, *available at* http://fortune.com/2015/07/08/say-on-pay-ceos/.
[23] *See* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate et al. (Sept. 6, 2016), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/September%206%20Letter%20to%20Senate%20Banking%20on%20Proxy%20Advisory%20Firms.pdf; Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Jeb Hensarling, Chairman, House Committee on Financial Services et al. (June 13, 2016) (letter co-signed by 27 CII members and other institutional investors strongly opposing H.R. 5311), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/06_13_16_FINAL_Letter_on_Proxy_Advisory_Firm_Bill.pdf; *see also* Editorial, Undermining Proxy-Voting Advice, Pensions & Invs., June 27, 2016, at 1 ("A bill pending in Congress would undermine proxy-voting firms and consequently weaken the capability of asset owners and other institutional investors to bring to bear their crucial resources to assist in voting on proxy issues at publicly traded companies") (registration required & on file with CII), *available at* http://www.pionline.com/article/20160627/PRINT/306279998/undermining-proxy-voting-advice.

Require that proxy advisory firms (1) provide companies advance copies of their recommendations and most elements of the research informing their reports, (2) give companies an opportunity to review and lobby the firms to change their recommendations, and (3) establish a heavy-handed "ombudsman" construct to address issues that companies raise.

This right of pre-review would give companies substantial influence over proxy advisory firms' reports, potentially undermining the objectivity of the firms' recommendations. On a practical level, this right of review would delay pension funds and other institutional investors' receipt of the reports and recommendations for which they have paid.
The requirement that the proxy advisory firms resolve company complaints prior to the voting on the matter would create an incentive for companies subject to criticism to delay publication of reports as long as possible. Pension funds and other institutional investors would have less time to analyze the reports and recommendations in the context of their own customized proxy voting guidelines to arrive at informed voting decisions. Time already is tight, particularly in the highly concentrated spring "proxy season," due to the limited period between company publication of the annual meeting proxy statement and annual meeting dates.

Moreover, the proposed legislation does not appear to contemplate a parallel requirement that dissidents in a proxy fight, or proponents of shareowner proposals, also receive the recommendations and research in advance. This would violate an underlying tenet of U.S. corporate governance that where matters are contested in corporate elections, management and dissident shareowners should operate on an even playing field.

Require the Securities and Exchange Commission (SEC) to assess the adequacy of proxy advisory firms' "financial and managerial resources."

The entities that are in the best position to make these types of assessments are the pension funds and other institutional investors that choose to purchase and use the proxy advisory firms' reports and recommendations. In 2014, the SEC staff issued guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents. We publicly supported that guidance. We are unaware of any compelling empirical evidence indicating that the guidance is not being followed or that the burdensome federal regulatory scheme contemplated by the proposed legislation is needed.

. . . .

The proposed legislation would appear to result in higher costs for pension plans and other institutional investors – potentially much higher costs if investors seek to maintain current levels of scrutiny and due diligence around proxy voting.

> Moreover, the proposed legislation is highly likely to limit competition, by reducing the current number of proxy advisory firms in the U.S. market and imposing serious barriers to entry for potential new firms. This would also drive up costs to investors. Given these economic impacts, we are troubled that there appears to be no cost estimate on the provisions of this proposed legislation.[24]

Our views are consistent with those of former SEC Director of Corporation Finance Keith F. Higgins who recently commented:

> Under this regime, proxy advisory firms would be required to register with the Commission, allow companies to review their reports before issuance, disclose potential conflicts of interest and provide financial reports. Although I don't dismiss concerns about the influence of proxy advisory firms, *I don't think the proposed regulatory regime is the answer*. Part of the problem in the industry is a lack of competition. For example, various sources report that the two largest players, ISS and Glass Lewis, control approximately 97% of the proxy advisory services market. It is unclear how added regulatory burdens will help promote competition. Typically, imposing additional regulation is a costly impediment to new entrants, and in turn, may bolster the incumbents' market position.
>
> *It is interesting that the clients who use proxy advisory reports don't seem to be complaining*. In fact, they often favor the ease, readability, and comparability of the reports.
>
> . . . .
>
> *I don't think placing an additional regulatory support superstructure on proxy advisory firms is the solution*.[25]

2. Promote Effective Disclosure and Reliable Financial Reporting

<u>Clawbacks</u>

CII opposes Section 849 of the Act because it would narrow the required scope for clawbacks of unearned compensation from corporate executives to those we had control or authority over the company's financial reporting.

We continue to support the SEC's issuance of a final rule in response to Section 954 of Dodd-Frank entitled, "Recovery of Erroneously Awarded Compensation." The SEC's proposed rule to

---

[24] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al., to The Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate et al. at 8-10 (footnotes omitted).

[25] Keith F. Higgins at 2-3.

implement Section 954 is generally consistent with CII's membership approved corporate governance policies.[26] Those policies state:

> The compensation committee should ensure that sufficient and appropriate mechanisms and policies (for example, bonus banks and clawback policies) are in place to recover erroneous bonus and incentive awards paid in cash, stock or any other form of remuneration to current or former executive officers, and to prevent such awards from being paid out in the first instance. Awards can be erroneous due to acts or omissions resulting in fraud, financial results that require restatement or some other cause that the committee believes warrants withholding or recovering incentive pay. Incentive-based compensation should be subject to recovery for a period of time of at least three years following discovery of the fraud or cause forming the basis for the recovery. The mechanisms and policies should be publicly disclosed.[27]

Consistent with our policies, we believe the final SEC rule should, as proposed,[28] apply broadly to the compensation of all current or former executive officers whether or not they had control or authority over the company's financial reporting.[29] As we explained in our comment letter to the SEC:

> In our view, establishment of a broad clawback arrangement is an essential element of a meaningful pay for performance philosophy. If executive officers are to be rewarded for "hitting their numbers"—and it turns out they failed to do so—the unearned compensation should generally be recovered notwithstanding the cause of the revision.[30]

We note that if the limitation of Section 849 were adopted, employees such as the former head of community banking at Wells Fargo, Carrie L. Tolstedt, would presumably not fall under the scope the required clawback.[31] Finally, we note that our support for a broad clawback policy appears to be consistent with the "Commonsense Principles of Corporate Governance" recently endorsed by a number of prominent leaders of U.S. public companies, including Mary Barra,

---

[26] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (proposed rule July 14, 2015), *available at* https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.

[27] § 5.5 Pay for Performance.

[28] *See* 80 Fed. Reg. at 41,153 ("the compensation recovery provisions of Section 10D apply without regard to an executive officer's responsibility for preparing the issuer's financial statements").

[29] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 5 (Aug. 27, 2015), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/08_27_15_letter_to_SEC_clawbacks.pdf;

[30] *Id.* (footnotes omitted).

[31] Nathan Bomey & Kevin McCoy, Wells Fargo clawing back $75.3 million more from former execs in fake accounts scandal, USA Today, April 10, 2017, at 1 (reporting that "the bank has canceled $47.3 million in additional stock options owed to Carrie Tolstedt, who previously headed the community banking division where the scandal erupted"), *available at* https://www.usatoday.com/story/money/2017/04/10/wells-fargo-compensation-clawback/100276472/.

General Motors Company; Jamie Dimon, JPMorgan Chase; Jeff Immelt, GE; and Lowell McAdam, Verizon.[32] Those principles state that "companies should maintain clawback policies for both cash and equity compensation" of management.[33]

Hedging

CII opposes Section 857(a)(25) of the Act because it would repeal the requirement that public corporations disclose whether their employees and directors can hedge their company's equity compensation.

We continue to support the SEC's issuance of a final rule in response to Section 955 of Dodd-Frank entitled, "Disclosure Regarding Employee and Director Hedging." The SEC's proposed rule to implement Section 955[34] has important implications for CII's long-standing membership approved corporate governance policies on hedging of compensation.[35] Those policies state:

> Compensation committees should prohibit executives and directors hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity based awards granted as long-term incentive compensation or other stock holdings in the company. And they should strongly discourage other employees from hedging their holdings in company stock.[36]

For those companies that have not yet fully adopted our policy, we believe that a final SEC rule, as proposed, would provide our members and other investors with a more complete understanding regarding the persons permitted to engage in hedging transactions and the types of hedging transactions allowed. Armed with the proposed disclosure, our members and other investors would be in a better position to make more informed investment and voting decisions, including voting decisions on proposals to adopt hedging policies, advisory votes on executive compensation and voting decisions in connection with the election of directors.

We, like the SEC, "are not aware of any reason why information about whether a company has policies affecting the alignment of shareholder interests with those of employees and directors would be less relevant to shareholders of an emerging growth company or a smaller reporting company than to shareholders of any other company."[37] Moreover, we generally agree with the SEC that given its narrow focus, it is unlikely that the proposed disclosure would "impose a significant compliance burden on [those] companies."[38]

---

[32] Commonsense Corporate Governance Principles VII(g) (July 2016), *available at* http://www.governanceprinciples.org/.
[33] *Id.*
[34] Disclosure of Hedging by Employees, Officers, and Directors, 80 Fed. Reg. 8486 (proposed Feb. 17, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-02-17/pdf/2015-02948.pdf.
[35] § 5.8d Hedging.
[36] *Id.*
[37] 80 Fed. Reg. at 8494.
[38] *Id.*

Finally, we believe the proposed disclosure also would benefit our members and other investors because the public nature of the required disclosure would result in more public companies adopting our hedging policy and enhancing long-term shareowner value. For all the above reasons, CII generally supports the issuance of a final rule as proposed.[39]

Chairman & CEO Structures

CII opposes Section 857(a)(31) of the Act because it would repeal required disclosures of public corporation's Chairman and CEO structures.

We note that the SEC adopted rules in December 2009 that, in effect, implemented the disclosure requirements of Section 972 of Dodd Frank entitled, "Disclosures Regarding Chairman and CEO Structure." CII's membership approved policies generally support appointment of an independent chair. Those policies state:

> The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who should have approval over information flow to the board, meeting agendas and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

CII members believe that the board leadership is critical to effective governance. We believe that even those who promote combination of chair and CEO roles generally share that view, and should have no objections to a disclosure requirement providing for clarity around the reasoning behind board leadership structure.

Finally, we note that our support for this disclosure appears to be consistent with the "Commonsense Principles of Corporate Governance" recently endorsed by a number of prominent leaders of U.S. public companies.[40] Those principles state that "board should explain clearly (ordinarily in the company's proxy statement) to shareholders why it has separated or combined the roles."[41]

Internal Controls

CII opposes Sections 441 and 847 of the Act that would further expand the existing exemptions for public corporations from having an external, independent auditor attest to, and report on, management's assessment of internal controls over financial reporting as generally required by

---

[39] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent Fields, Secretary, U.S. Securities and Exchange Commission 3 (Apr. 16, 2015), *available at* https://www.sec.gov/comments/s7-01-15/s70115-5.pdf.

[40] Commonsense Corporate Governance Principles at V(a).

[41] *Id*.

Section 404(b) of the Sarbanes-Oxley Act. As explained in a joint letter from CII and the Center for Audit Quality in response to a recent SEC proposal:

> We believe that any amendment that erodes Section 404(b) would substantially impact the quality of financial reporting by public companies to the detriment of investors and our capital markets more generally . . . We believe Section 404(b) continues to be significant as it provides investors with reasonable assurance from the independent auditor that a company maintained effective internal control over financial reporting. This assurance is an important driver of confidence in the integrity of financial statements and in the fairness of our capital markets. A Government Accountability Office report found that companies exempted from Section 404(b) experience more financial restatements, as compared to nonexempt companies; and the percentage of exempt companies restating has generally exceeded that of nonexempt companies. According to this report, companies that obtained an auditor attestation generally had fewer financial restatements than those that did not.
>
> Complying with Section 404(b) has a benefit for issuers. Academic research has demonstrated that the cost of capital for companies that voluntarily comply with Section 404(b) is lower than peer companies and has decreased for public companies since enactment of the Sarbanes-Oxley Act, especially for smaller companies.
>
> Lastly, while the cost of compliance with Section 404(b) is often cited as a concern by issuers, an SEC study concluded that such costs have declined by approximately 30% after the PCAOB adopted Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and the SEC issued management guidance on Section 404(a) in 2007.[42]

<u>Governmental Accounting Standards Board (GASB)</u>

CII opposes Section 857(a)(34) of the Act that repeals an existing market-based accounting support fee for the GASB. As we explained in a recent letter to you:

> On behalf of . . . CII, we write to urge you exclude from the Financial CHOICE Act any provision that repeals section 978 of . . . Dodd-Frank . . . that provides a funding mechanism for the . . . GASB.
>
> . . . .
>
> The GASB funding mechanism currently in place provides the GASB with an independent, conflict-free source of funds in order to carry out its important mission

[42] Letter from Cynthia M. Fornelli, Executive Director, Center for Audit Quality & Jeff Mahoney, General Council, Council of Institutional Investors, to U.S. Securities and Exchange Commission 2-3 (Aug. 30, 2016) (footnotes omitted), *available at* https://www.sec.gov/comments/s7-12-16/s71216-17.pdf.

> of establishing accounting and financial reporting standards for U.S. state and local governments that follow Generally Accepted Accounting Principles (GAAP).
>
> The independent and predictable source of funds that GASB receives benefits taxpayers and investors because it is free of the conflicts of interest, real or perceived, that were inherent in GASB's old funding source that required GASB's parent, the Financial Accounting Foundation, to solicit voluntary contributions from the very entities that would be bound by its accounting standards. We should not go back to this practice that undermines investor confidence.
>
> We support the GASB's important work and urge you to exclude any provision in your legislation that repeals GASB's current funding mechanism.[43]

3. Safeguard the Independence of the SEC

SEC Rulemaking

CII would amend Sections 311 and 334 of the Act to remove the SEC from the cost-benefit analysis and Congressional review provisions of Title III, Subtitle A and B of the Act, respectively.

As an association of long-term shareowners interested in maximizing share values, we believe it is vital to avoid unnecessary regulatory costs. However, it is not clear to us how the provisions of the Act would improve the cost-effectiveness of the SEC's existing rulemaking process or benefit long-term investors, the capital markets or the overall economy.

We note, for example, that the Act's provisions do not contain any language that would explicitly require the SEC to consider the costs and benefits of a proposal or rule from the perspective of long-term investors. Moreover, as we explained in a recent letter to Speaker Ryan and Minority Leader Pelosi regarding similar cost-benefit provisions of H.R. 78:

> The Commission's rulemaking process is already governed by a number of legal requirements, including those under the federal securities laws, the Administrative Procedure Act, the Paperwork Reduction Act of 1980, the Small Business Regulatory Enforcement Fairness Act of 1996 and the Regulatory Flexibility Act. Moreover, under the federal securities laws, the SEC is generally required to consider whether its rulemakings are in the public interest and will protect investors and promote efficiency, competition and capital formation.

---

[43] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Jeb Hensarling, Chairman, Committee on Financial Services, U.S. House of Representatives 1-2 (Feb. 9, 2017) (footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/February%209,%202017%20GASB.pdf.

> Since the 1980s, the Commission has conducted, to the extent possible, an analysis of the costs and benefits of its proposed rules. The SEC has further enhanced the economic analysis of its rulemaking process in recent years. That process is far more extensive than that of any other federal financial regulator.
>
> . . . .
>
> The [cost-benefit] provisions . . . would create a false and misleading expectation that the SEC can reasonably measure, combine and compare the balance of all costs and benefits of its proposals consistent with its mandate to protect investors. As explained by Professor Craig M. Lewis, former chief economist and director of the SEC's Division of Economic and Risk Analysis: "[W]ith regard to investor protection, the Commission is often unable to reasonably quantify the related benefits or costs."
>
> [The cost-benefit provisions] . . . would impose upon the SEC a costly, time consuming and incomplete analysis in which the Commission would be hard pressed to determine that the benefits of a proposal or rule "justify the costs of the regulation."[44]

The application of the Act's Congressional review provisions to SEC rulemaking is perhaps even more troubling for long-term investors. On this issue, we generally agree with the following comments of Broc Romanek of the TheCorporateCounsel.net:

> The "Financial Choice Act" is much more than merely repealing big chunks of Dodd-Frank. There are a handful of provisions that would render the SEC's ability to conduct rulemaking much more difficult. But this provision in particular . . . just blows me away:
>
> . . . A joint Congressional resolution to adopt a "major" rule – and even some non-major ones! [Its] goal appears to be neutering the so-called "independent" federal agencies that govern our financial institutions & markets. Talk about putting partisan politics into "independent" agencies. And here I was worried that having Congress involved in the SEC's budget process was too much meddling with a federal agency!
>
> Remember that federal agencies are part of the executive branch of government. Not to mention that members of Congress don't have the expertise, resources or time to understand what the various rules of an agency are. This would be a major windfall for lobbyists who would be able to effectively pay Congress to stop an agency from doing anything. Either the Senate or the House could stop a

[44] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Paul D. Ryan, United States House of Representatives et al. 2-3 (Jan. 11, 2017) (footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2017/01_11_17_letter_house_leadership_HR78.pdf.

> rulemaking – by simply sitting on their hands. The polar opposite of needing an "Act of Congress" to change something. It's brazen & breathtaking – and a whole lot of other things that I can't mention in this family-oriented blog.[45]

We believe the Title III, Subpart A and B provisions, individually, and particularly when combined, would unnecessarily constrain the ability of the SEC to issue any substantive proposals in furtherance of its mission to protect investors—the element of its mission that, in our view, is most critical to maintaining and enhancing a fair and efficient capital market system.

Compensation Structure

CII opposes Section 857(a)(26) of the Act because it would repeal requirements to improve executive pay practices at financial institutions.

We continue to support the issuance of a final rule by the SEC and the federal financial regulators in response to Section 956 of Dodd-Frank titled, "Enhanced Compensation Structure Reporting." As we stated in our comment letter in response to the federal financial regulators proposed rule to implement Section 956,[46] the proposal is "largely consistent with CII's member-approved policies on executive compensation."[47] Those policies support reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the long-term, consistent with a company's investment horizon.[48] In light of those policies and the experience of the financial crisis,[49] our comment letter concludes:

> [We support] the proposed rule's over-arching requirements that incentive-based compensation arrangements at covered financial institutions 1) appropriately balance risk and reward, and 2) bar arrangements that could encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss. We also support the proposed rule's recognition of the board's important role to oversee incentive-based compensation programs.[50]

---

[45] Broc Romanek, Financial CHOICE Act: One Provision Could Destroy the SEC's Rulemaking, TheCorporateCounsel.net Blog (Nov. 17, 2016), *available at* https://www.thecorporatecounsel.net/miscccnet/bio.htm.

[46] Incentive-Based Compensation Arrangements, 81 Fed. Reg. 112 (proposed rule June 10, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-06-10/pdf/2016-11788.pdf.

[47] Letter from Glenn Davis, Director of Research, Council of Institutional Investors, to Patrick T. Tierney, Assistant Director, Department of Treasury, Office of the Comptroller of the Currency, Legislative and Regulatory Activities Division et al. 2 (July 15, 2016), *available at* http://www.federalreserve.gov/SECRS/2016/July/20160721/R-1536/R-1536_071516_130346_394428687994_1.pdf.

[48] § 5.1 Introduction.

[49] Investors Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 22 (July 2009) (concluding that the global financial crisis resulted, in part, from "too many boards approv[ing] executive compensation plans that rewarded excessive risk-taking"), *available at* http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

[50] Letter from Glenn Davis at 3.

We believe the issuance of a final rule, as proposed, appropriately preserves a role for incentive-based compensation at financial institutions and places a greater emphasis on risk management and long-term outcomes. The result should be greater stability for the overall market.

Proxy Access

CII opposes Section 857(a)(30) of the Act that would repeal authority of the SEC to issue a proxy access rule.

We believe that proxy access—a mechanism that enables shareowners to place their nominees for director on a company's proxy card—is a fundamental right of long-term shareowners. Proxy access gives shareowners a meaningful voice in board elections. Without effective proxy access, the director election process at many companies simply offers little more than a ratification of management's slate of nominees.

Our member-approved policy on proxy access states, in part:

> Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least 3% of a company's voting stock, to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years.[51]

We also generally support an approach to proxy access similar to the one that the SEC adopted in 2010 but was later vacated after a court challenge. Now, more than 400 U.S. public companies have adopted proxy access in a form generally consistent with our policy.[52] That includes 11% of the Russell 3000, constituting more than half of the index's total market capitalization, and about half of the S&P 500.[53]

The companies that implemented proxy access are from a variety of industries. They include Intercontinental Exchange (the parent company of the New York Stock Exchange), Apple, United Airlines, CarMax, JPMorgan Chase and Apache.

Relying on private ordering rather than a uniform approach envisaged by the SEC in 2010 has led to myriad versions of proxy access, at greater legal expense than with a uniform rule, and with the potential for various creative provisions that seem aimed at making it difficult for shareowners to use the mechanism.[54] Given the clear growing trend of public companies adopting proxy access, and the increasing complexity and related costs resulting from the current private ordering process, there may soon come a time when companies and their shareowners will favor a more uniform, less costly set of standards and requirements for proxy access. If that

---

[51] § 3.2 Access to Proxy.
[52] CII, Proxy Access by Private Ordering (Feb. 2017), *available at* http://www.cii.org/files/publications/misc/02_02_17_proxy_access_private_ordering_final.pdf.
[53] *Id.*
[54] *See id*. at 10.

time should arrive, Section 971 would facilitate the SEC's ability to respond with rule-making in a more cost-effective manner.

Private Equity

CII opposes Section 858 of the Act because it would remove transparency in private equity by requiring the SEC to exempt advisors to private equity funds from registration and reporting.

We continue to agree with the 2009 recommendation of the Investor Working Group that all investment managers of funds available to U.S. investors, including private equity funds, should be required to register with the SEC as investment advisers and be subject to oversight and disclosure requirements.[55] As has been widely reported, the existing registration and reporting requirements for advisers to private equity funds has led "firms such as KKR, Blackstone and Apollo Global Management LLC Group to [pay] . . . tens of millions in fines . . . after SEC examinations uncovered what regulators said were insufficient disclosures of some fee and expense practices to clients."[56] We believe that the Act's provisions to eliminate registration and reporting requirements for advisors to private equity funds would harm the SEC's investor protection efforts, disadvantage fund managers that currently follow best practices, as well as expose long-term investors and all taxpayers to potentially greater financial stability risks.[57]

****

Thank you for considering our initial views on the Act. We would be very happy to discuss our perspective on these and other issues with you or your staff at your convenience. I am available at jeff@cii.org or by telephone at (202) 822-0800.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

---

[55] Investors Working Group at 16 ("All investment advisers and brokers offering investment advice should have to meet uniform registration requirements, regardless of the amount of assets under management, the type of product they offer or the sophistication of investors they serve[] [e]xemptions from registration should not be permitted").
[56] *See, e.g.,* Melissa Mittelman, Private Equity Eyes Tax and Financial Reform in the Trump Era, Bloomberg, Jan. 19, 2017, at 3, *available at* https://www.bloomberg.com/news/articles/2017-01-19/with-close-trump-ties-private-equity-eyes-tax-financial-reform.
[57] *See, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Paul D. Ryan, Speaker, United States House of Representatives et al. 1-2 (Sept. 7, 2016) (opposing proposed legislation that would roll back transparency and reporting requirements for private equity funds because it would inhibit the ability to monitor systemic risk and protect investors), *available at* www.cii.org/files/issues_and_advocacy/correspondence/2016/Sept%207%202016%20Letter%20to%20Speaker%20regarding%20H%20R%20%205424%20(003).docx%20(final).pdf.