Via Hand Delivery

September 12, 2016

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: Markup of the Financial CHOICE Act of 2016

Dear Mr. Chairman and Ranking Member Waters:

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.[1]

The purpose of this letter is to share with you some of our initial concerns about several provisions of the Financial CHOICE Act of 2016 in connection with your Committee's plans to meet to debate the act tomorrow Tuesday, September 13.[2] In that regard, we would respectfully request that this letter be included in the public record for that meeting.

Say-on-Pay

CII opposes Section 443 the act that would amend Section 951, Shareholder Vote on Executive Compensation Disclosures, of the Dodd-Frank Wall Street Reform and Consumer Protection Act

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[1] 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.
[2] Financial CHOICE Act of 2016, H.R. __, 114th Cong. (Discussion Draft June 23, 2016), *available at* http://financialservices.house.gov/uploadedfiles/choice_act-_discussion_draft.pdf.

(Dodd-Frank). Section 443 would in effect reduce the frequency of say-on-pay votes.[3] The requirements of Section 951, as implemented by the U.S. Securities and Exchange Commission (SEC),[4] are generally consistent with CII's membership-approved corporate governance policies.[5] Those policies state:

> All companies should provide annually for advisory shareowner votes on the compensation of senior executives.[6]

While Section 951(a) of Dodd-Frank, as implemented by the SEC, provides for say-on-pay votes to be held either annually, biennially, or triennially, to-date 80 percent of public companies have opted for annual votes consistent with our policy.[7] 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 accommodation of board discretion.

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[8] that they are unable to rationalize.[9]

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[3] Financial CHOICE Act of 2016, § 443 (would amend the requirement that public companies provide shareowners with a vote on executive compensation to occur only when the company has made a material change to the executive compensation policy).
[4] Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6009 (Feb, 2, 2011), https://www.gpo.gov/fdsys/pkg/FR-2011-02-02/pdf/2011-1971.pdf
[5] Council of Institutional Investors, Policies on Corporate Governance, § 5.2 Advisory Shareowner Votes on Executive Pay (updated Apr. 1, 2015), http://www.cii.org/files/committees/policies/2015/04_01_15_corp_gov_policies.pdf.
[6] *Id.*
[7] *See*, *e.g.*, Emily Chasen, Most Companies Opt for Annual Say-on-Pay Votes, Wall St. J., Apr. 9, 2013, at 1, *available at* http://blogs.wsj.com/cfo/2013/04/09/most-companies-opt-for-annual-say-on-pay-votes/.
[8] § 5.12 Perquisites ("Executives, not companies, should be responsible for paying personal expenses—particularly those that average employees routinely shoulder, such as family and personal travel, financial planning, club memberships and other dues.").
[9] *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/.

Clawbacks

CII opposes Section 447 of the act, which would amend Section 954, Recovery of Erroneously Awarded Compensation, of Dodd-Frank. Section 447 would narrow the scope of the clawback requirement.[10] The SEC's outstanding proposed rule to implement Section 954[11] is generally consistent with CII's membership-approved corporate governance policies.[12] 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.[13]

We believe the SEC should issue a final rule, as proposed,[14] that applies 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.[15] 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.[16]

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[10] Financial CHOICE Act of 2016, § 447 (would limit clawbacks of compensation to the current or former executive officers of a public company who had control or authority over the company's financial reporting).
[11] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (proposed July 14, 2015), *available at* https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.
[12] § 5.5 Pay for Performance.
[13] *Id.*
[14] 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").
[15] 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), http://www.cii.org/files/issues_and_advocacy/correspondence/2015/08_27_15_letter_to_SEC_clawbacks.pdf;
[16] Letter from Jeff Mahoney at 5 (footnotes omitted).

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, General Motors Company; Jamie Dimon, JPMorgan Chase; Jeff Immelt, GE; and Lowell McAdam, Verizon.[17] Those principles state that "companies should maintain clawback policies for both cash and equity compensation" of management.[18]

<u>Hedging</u>

CII opposes Section 449(25) of the act that would repeal Section 955, Disclosure Regarding Employee and Director Hedging, of Dodd-Frank.[19] The SEC's proposed rule to implement Section 955[20] has important implications for CII's long-standing membership-approved corporate governance policies on hedging of compensation.[21] 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.[22]

For those companies that have not yet fully adopted our policy, we agree that the SEC should issue a final rule, as proposed, that 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.

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[17] Commonsense Corporate Governance Principles (July 2016), *available at* http://www.governanceprinciples.org/. We note that JPMorgan Chase and GE are associate members of CII.
[18] Commonsense Principles of Corporate Governance VII(g) (July 2016), *available at* http://www.governanceprinciples.org/wp-content/uploads/2016/07/GovernancePrinciples_Principles.pdf.
[19] Financial CHOICE Act of 2016, § 449(25) (would repeal the reporting requirement for public companies regarding employee or board member hedging of equity securities granted as compensation).
[20] 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.
[21] § 5.8d Hedging.
[22] *Id.*

We, like the commission, "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."[23] Moreover, we generally agree with the commission that given its narrow focus, it is unlikely that the proposed disclosure would "impose a significant compliance burden on [those] companies."[24]

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 of the above reasons, CII generally supports the issuance of a final rule as proposed.[25]

Compensation Structure

CII opposes Section 449(26) of the act that would repeal Section 956, Enhanced Compensation Structure Reporting, of Dodd-Frank.[26] As we stated in our recent comment letter in response to the federal financial regulators proposed rule to implement Section 956,[27] the proposal is "largely consistent with CII's member-approved policies on executive compensation."[28] 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.[29] In light of those policies and the experience of the financial crisis,[30] 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

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[23] 80 Fed. Reg. at 8494.
[24] *Id.*
[25] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent Fields, Secretary, U.S. Securities and Exchange Commission 3 (Apr. 16, 2015), https://www.sec.gov/comments/s7-01-15/s70115-5.pdf.
[26] Financial CHOICE Act of 2016, § 449(26) (would repeal federal financial regulators' ability to issue rules relating to incentive-based compensation arrangements).
[27] Incentive-Based Compensation Arrangements, 81 Fed. Reg. 112 (proposed June 10, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-06-10/pdf/2016-11788.pdf.
[28] 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.
[29] § 5.1 Executive Compensation—Introduction ("The Council endorses 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.").
[30] 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.

> 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.[31]

We support the issuance of a final rule, as proposed, because we believe it would appropriately preserve a role for incentive-based compensation at financial institutions and place 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 449(30) of the act that would repeal Section 971, Proxy Access, of Dodd-Frank.[32] 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.[33] Proxy access gives shareowners a meaningful voice in board elections.

CII's 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 three percent 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.[34]

CII also generally supports 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 five years later, about 240 U.S. public companies have adopted proxy access in a form generally consistent with our policy.[35]

According to ISS Corporate Solutions, 38 percent of the S&P 500 have a proxy access process.[36] 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.[37]

Given the clear growing trend of public companies adopting proxy access, there may come a time when both companies and shareowners favor a more uniform minimal set of standards and

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[31] Letter from Glenn Davis at 3.
[32] Financial CHOICE Act of 2016, § 449(30) (would repeal the U.S. Securities and Exchange Commission's authority to issue rules on proxy access).
[33] CII, Proxy Access: Best Practices 2 (Aug. 2015), *available at* http://www.cii.org/files/publications/misc/08_05_15_Best%20Practices%20-%20Proxy%20Access.pdf.
[34] § 3.2 Access to the Proxy.
[35] *See, e.g.*, Yin Wilczek, What's Next for Proxy Access?, Corporate Transactions Blog, BloombergBNA 2 (Aug. 4, 2016), *available at* http://www.bna.com/whats-next-proxy-b73014445868/.
[36] *Id.*
[37] *Id.*

requirements for proxy access. If that time should arrive, Section 971 would facilitate the SEC's ability to respond and provide any needed standards and requirements.

Chairman & CEO Structures

CII opposes Section 449(31) of the act that would repeal Section 972, Disclosures Regarding Chairman and CEO Structures, of Dodd-Frank.[38] We note that the SEC adopted rules in December 2009 that, in effect, implemented the disclosure requirements of Section 972.[39] Those rules were generally consistent with CII's membership approved policies.[40] 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.[41]

Now, more than six years later, we continue to strongly support the SEC's required leadership structure disclosures, particularly in light of the growing body of evidence indicating that splitting the chairman and CEO roles may "save money and improve company's performance."[42]

Internal Controls

CII opposes Section 445 of the act that would further expand the existing exemptions for public companies[43] from having an external, independent auditor attest to, and report on, management's assessment of internal controls over financial reporting as generally required by Section 404(b)

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[38] Financial CHOICE Act of 2016, § 449(31) (would repeal the U.S. Securities and Exchange Commission's change authority to issue rules to require disclosure regarding Chairman and CEO structures).
[39] Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, at 68,345 (Dec. 23, 2009) ("the amendments were designed to provide shareholders with disclosure of, and the reasons for, the leadership structure of a company's board concerning the principal executive officer, the board chairman position and, where applicable, the lead independent director position"), *available at* https://www.gpo.gov/fdsys/pkg/FR-2009-12-23/pdf/E9-30327.pdf.
[40] § 2.4 Independent Chair/Lead Director.
[41] *Id.*
[42] Paul Hodgson, Should the Chairman be the CEO?, Fortune.com, Oct. 21, 2014, at 2, *available at* http://fortune.com/2014/10/21/chairman-ceo..
[43] *See, e.g.*, Guide to Internal Control over Financial Reporting 11 (Mar. 21, 2013) (Public companies currently exempt from an audit of internal control over financial reporting include investment companies, non-accelerated filers, and emerging growth companies), *available at* http://www.thecaq.org/guide-internal-control-over-financial-reporting.

of the Sarbanes-Oxley Act.[44] As explained in a comment letter from CII and the Center for Audit Quality in response to a recent SEC proposal:[45]

> 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.
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> 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.
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> 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 percent 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.[46]

Proxy Advisory Firms

CII opposes Sections 1081 to 1083 of the act that would unduly restrict the ability of proxy advisory firms to provide voting information to institutional investors who voluntary contract for

[44] Financial CHOICE Act of 2016, § 445 (would expand the Sarbanes-Oxley Act Section 404(b) exemption for non-accelerated filers to include issuers with up to $250 million in market capitalization or $1 billion in assets for banks).
[45] Amendments to Smaller Reporting Company Definition, 81 Fed. Reg. 43,130 (proposed July 1, 2016), *available at* https://www.federalregister.gov/documents/2016/07/01/2016-15674/amendments-to-smaller-reporting-company-definition.
[46] Letter from Cynthia M. Fornelli, Executive Director, Center for Audit Quality & Jeff Mahoney, General Counsel, Council of Institutional Investors, to U.S. Securities and Exchange Commission 2-3 (Aug. 30, 2016) (footnotes omitted), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2016/8-30-16%20CAQ%20and%20CII%20Smaller%20Reporting%20Company%20Definition%20Comment%20Letter.pdf.

such information.[47] 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.

As you may be aware, just last week we provided you with a copy of a letter co-signed by 30 CII members and other organizations expressing concerns about the proxy advisory firm provisions incorporated into the act.[48] Those provisions and our specific related concerns include the following:

> **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.**
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> 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.
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> 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

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[47] Financial CHOICE Act of 2016, §§ 1081-1083 (incorporating the provisions of H.R. 5311 which establish a regulatory scheme for proxy advisory firms).

[48] *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/2016/09-06-16%20-%20CII%20letter%20to%20Senate%20Banking%20on%20Proxy%20Advisory%20Firms.pdf; *see* 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 [H.R. 5311] 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.

> 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.
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> **Require the Securities and Exchange Commission (SEC) to assess the adequacy of proxy advisory firms' "financial and managerial resources**."
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> 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.
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> . . . .
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> 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.[49]

<u>SEC Rulemaking</u>

CII opposes Sections 611 to 621 of the act that would replace the SEC's existing economic analysis for rulemaking.[50] As an association of long-term shareowners interested in maximizing share values, CII believes 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

[49] Letter from Kenneth A. Bertsch at 2-3 (footnotes omitted).
[50] Financial CHOICE Act of 2016, §§ 611-621 (would replace the existing economic analysis performed by the SEC and other financial regulators).

economy. The SEC'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.[51]

Moreover, under the federal securities laws, the SEC generally is required to consider whether its rulemakings are in the public interest and, in addition to the protection of investors, whether they promote efficiency, competition and capital formation.[52] Since the 1980s, the SEC has conducted, to the extent possible, analyses of the costs and benefits of its proposed rules.[53]

The SEC has further enhanced the economic analysis of its rulemaking process in recent years.[54] That process is, and has long been, far more extensive than that of any other federal financial regulator.

We believe the act's provisions would pose substantial risk to the SEC's regulatory capacity and to the capital markets. The provisions are based on a faulty premise that a generally accepted methodology currently exists that allows the SEC in a cost-effective manner to reliably measure, and then balance, all of the costs and benefits of its proposals consistent with its mandate to protect investors. We note it is well established that while some of the costs of some financial regulatory proposals can be reliably estimated, the same is generally not true for the benefits.[55]

In most instances, the benefits as well as many of the costs of an SEC rule designed to protect investors, cannot be reliably measured.[56] Thus, the act's provisions would appear to impose on the SEC a costly, one-sided, incomplete analysis in which the commission would likely never be able to conclude that the quantified benefits of a proposal outweigh the quantified costs. As a

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[51] *See, e.g.,* Financial Services and Bailouts of Public and Private Programs: Hearing Before the H. Subcomm. on TARP of the Comm. on Oversight and Gov't Reform, 112th Cong. 2 (Apr, 17, 2012) (testimony of Chairman Mary L. Schapiro, U.S. SEC), *available at* http://www.sec.gov/news/testimony/2012/ts041712mls.htm.
[52] *Id.*
[53] *Id* at 3.
[54] *See, e.g.,* U.S. Securities and Exchange Commission, Office of Inspector General, Office of Audits, Use of the Current Guidance on Economic Analysis in SEC Rulemakings ii (June 6, 2013) (Noting that the Office of General Counsel and the Division of Risk, Strategy, and Financial Innovation, adopted six recommendations from the Office of Inspector General to further improve the SEC's already "effective" economic analysis for rule releases), *available at* https://www.sec.gov/about/offices/oig/reports/audits/2013/518.pdf.
[55] *See, e.g.,* U.S. Government Accountability Office, GAO-13-101, Dodd-Frank Act: Agencies' Efforts to Analyze and Coordinate Their Rules 18 (Dec. 2012) ("As we have reported, the difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure."), http://www.gao.gov/assets/660/650947.pdf.
[56] *See, e.g.,* Craig M. Lewis, Chief Economist and Director, Division of Risk, Strategy, Financial Innovation, U.S. Securities and Exchange Commission, Speech at the Pennsylvania Association of, Public Employee Retirement Systems Annual Spring Forum, Harrisburg, PA: Investor Protection Through Economic Analysis 3 (May 23, 2013) ("with regard to investor protection, the Commission is often unable to reasonably quantify the related benefits or costs"), *available at* https://www.sec.gov/News/Speech/Detail/Speech/1365171575422.

result, the Act's provisions 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.

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Thank you for considering these views. We would be very happy to discuss our perspective on these 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