

Via Hand Delivery

June 27, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: June 28, 2018 hearing entitled “Legislative Proposals to Examine Corporate Governance”¹

Dear Mr. Chairman and Ranking Member Brown:

I am writing on behalf of the Council of Institutional Investors (CII), a nonpartisan, nonprofit association of public, corporate, and union employee benefit funds, other employee benefit plans, foundations, and endowments with combined assets under management exceeding \$3.5 trillion. Our member funds include major long-term shareholders 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 \$25 trillion in assets under management, most also with long-term investment horizons. CII members share a commitment to healthy public capital markets and strong corporate governance.²

The purpose of this letter is to thank you for holding the above referenced hearing and to share with you a summary of our views on corporate governance and two of the legislative proposals that we understand are likely to be discussed at the hearing and are of particular interest to our members. We would respectfully request that this letter be included in the hearing record.

¹ United States Senate Committee on Banking, Housing, and Urban Affairs, Hearings, <https://www.banking.senate.gov/hearings>.

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. We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), are non-voting associate members of CII, paying an aggregate of \$24,000 in annual dues—less than 1.0 percent of CII’s membership revenues. In addition, CII is a client of ISS, paying approximately \$19,600 annually to ISS for its proxy research.

Corporate Governance

CII has long held that good corporate governance—defined to include market transparency, integrity and accountability of management to boards and shareowners—is in the best long-term interests of shareowners and the U.S. capital markets.³

We believe that shareowners, other investors and other stakeholders benefit when rules and regulations provide adequate protections to owners and ensure that important information is promptly and transparently provided to the marketplace.⁴

The value of good governance structures and practices within public companies—such as substantially independent boards,⁵ all-independent key committees,⁶ and measures to promote board accountability⁷—is backed by common sense and experience. We believe such structures and practices ensure that directors have the necessary independence from management to, among other things, monitor and assess corporate performance; select, monitor, evaluate and, when necessary, replace the chief executive and other senior managers; oversee management succession; and structure, monitor and approve compensation paid to the chief executive and other senior managers. They also ensure that directors are accountable to shareowners.

We are unaware of any evidence of a causal connection between federally imposed improvements to corporate governance and the decline in the number initial public offerings or public businesses in the United States.⁸

³ CII, Policies on Other Issues, Value of Corporate Governance, http://www.cii.org/policies_other_issues#value_corp_gov.

⁴ *Id.*

⁵ See Council of Institutional Investors, Corporate Governance Policies § 2.3 Independent Board (Updated September 15, 2017), https://www.cii.org/files/policies/09_15_17_corp_gov_policies.pdf.

⁶ See Corporate Governance Policies § 2.5 All-independent Board Committees.

⁷ See, Corporate Governance Policies § 2.1 Annual Election of Directors; § 2.6 Board Accountability to Shareholders (stating that boards should seek shareholder views on important governance, management, and performance matters and take actions recommended by shareholder proposals that receive a majority of votes cast for and against).

⁸ See Michael J. Mauboussin et al., Credit Suisse, “The Incredible Shrinking Universe of Stocks, The Causes and Consequences of Fewer U.S. Equities” 20 (Mar. 22, 2017) (“the shrinkage in the population of listed companies started well before . . . [Sarbanes-Oxley Act] was implemented”), https://www.cmgwealth.com/wp-content/uploads/2017/03/document_1072753661.pdf; Office of Investor Advocate, U.S. Securities and Exchange Commission, Report on Objectives 6 (2018) (“recent academic studies demonstrate that it is difficult to establish any causal connection between disclosure mandates and IPO activity”), <https://www.sec.gov/files/sec-office-investor-advocate-report-on-objectives-fy2018.pdf>; “Legislative Proposals to Help Fuel Capital and Growth on Main Street:” Hearing before the H. Subcomm. Cap. Markets, Sec., & Investment, 115th Cong. (May 23, 2018) (Statement of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School at 2) (“the decline of IPO’s . . . cannot be blamed on an over-regulating national regulator”), <https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-jcoffee-20180523.pdf>; Elisabeth de Fontenay, “The Deregulation of Private Capital and the Decline of the Public Company,” 68 *Hastings L.J.* 445, 448 (Mar. 29, 2017) (“even if public company disclosure requirements had remained constant over the last three decades, there would likely still be a dearth of public companies today, due to the increasing ease of raising capital privately”) available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/elisabeth-de-fontenay-deregulation-private-capital.pdf>.

Proxy Advisory Firms

Many CII members and other institutional investors voluntarily contract with proxy advisory firms to obtain cost-effective independent research to help inform their proxy voting and engagement decisions, and to execute votes based on funds' own proxy voting guidelines. Proxy voting is a critical means by which shareowners hold corporate executives and boards to account and is a hallmark of shareholder ownership and accountability. The system of corporate governance in the United States relies on the accountability of Chief Executive Officers and boards of directors alike to shareowners, and ensuring unencumbered shareholder access to independent research is a crucial underpinning of effective corporate governance.

H.R. 4015⁹

H.R. 4015 would require, as a matter of federal law, that proxy advisory firms share their research reports and proxy voting recommendations with the companies about whom they are writing before they are shared with the institutional investors who are their paying clients.¹⁰ While the stated goal of the proposed legislation is the “protection of investors,”¹¹ we believe the legislation would bias proxy advisory firms in favor of corporate management on matters about which there are significant differences of view. We also believe that the new requirements it would impose are unnecessary, overly burdensome and counter-productive. Many investors and investor organizations outside of CII's membership share our concerns.¹²

Further, the proposed legislation appears to be based on several false premises, including the erroneous conclusions that: (1) proxy advisory firms initiate many of the so-called “activist” hedge fund agendas; (2) proxy advisory firms dictate proxy voting results; and (3) institutional investors do not drive or form their own voting decisions. Indeed, while many pension funds and other institutional investors contract with proxy advisory firms to review their research, most large holders have adopted their own policies and may employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.

In short, most large institutional investors do not “rubber stamp” the proxy advisory firms' recommendations. Rather, they vote their proxies according to their own guidelines. While many large institutional investors rely on proxy advisors to help them manage the analysis of issues presented in the proxy statements accompanying thousands of shareholder meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.

⁹ H.R. 4015, 115th Cong. (Dec. 21, 2017), <https://www.congress.gov/115/bills/hr4015/BILLS-115hr4015rfs.pdf>.

¹⁰ H.R. 4015 § 3(a).

¹¹ *Id.* at Preamble.

¹² See Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Michael Crapo, Chairman, Committee on Banking, Housing, and Urban Affairs et al. (Feb. 27, 2018) (signed by 48 investors and investor organizations including many investors and investor organizations that are not currently members of CII), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/Feb%2027-18%20Final%20Letter%20CII%20on%20proxy%20advisor%20legislation.pdf; see also Letter from Thomas P. DiNapoli, NYS Comptroller et al. to The Honorable Charles E. Schumer, Minority Leader, United States Senate (May 29, 2018) (“On behalf of the more than two million state, city, and local government employees, teachers, retirees, and beneficiaries, we urge your strenuous opposition to . . . H.R. 4015 in the Senate.”) (on file with CII).

The independence that shareowners exercise when voting their proxies is evident in the statistics related to “say on pay” proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended voting against say-on-pay proposals at 11.8% of Russell 3000 companies in 2017, only 1.4% of those proposals received less than majority support from shareowners.¹³ Similarly, although ISS recommended voting against or withholding votes from the election of 10.8% of uncontested director-nominees, just 0.2% failed to obtain majority support.¹⁴

We are particularly concerned that if enacted, H.R. 4015, while providing no clear benefits to institutional investors, would:

- Grant companies the right to review the proxy advisory firms’ research reports before the paying customers – investors – receive the reports;¹⁵
- Mandate that proxy advisory firms hire an ombudsman to receive and resolve corporations’ complaints;¹⁶
- Require proxy advisory firms to publish a company’s statement “detailing its complaints” in the proxy advisory firms’ final reports to their clients, if the ombudsman is unable to resolve these complaints and if the company makes the request in writing; and¹⁷
- Increase barriers to new entrants and potentially lead some current proxy advisory firms to exit the industry altogether.

Giving corporate issuers the “right to review” the proxy advisors’ work product before the reports go to the paying customers is unprecedented. It would give corporate management substantial undue influence over proxy advisory firms’ reports. The approach would create a dynamic that would encourage proxy advisory firms to view management as their research clients, rather than the investors who contract for this research.

Another concern is that such forced pre-publication review may not be consistent with First Amendment rights to freedom of speech. Regardless, the attempt by government fiat to interpose corporate management between investors and those whom investors voluntarily hire to provide them with independent research is highly questionable as a matter of public policy and inconsistent with free-market principles.

Practically, the additional regulatory hurdles imposed would: (1) increase the complexity of the challenges faced by the proxy advisory firms; (2) impose even more severe time constraints on the production of reports; and, without doubt, (3) add significant resource burdens that would increase the cost of their services. The higher costs would likely be passed along to their institutional investor clients.

¹³ ISS Voting Analytics Database (June 21, 2018) (on file with CII).

¹⁴ *Id.*

¹⁵ H.R. 4015 § 3(a).

¹⁶ *Id.*

¹⁷ *Id.*

Under H.R. 4015, pension funds and other institutional investors would have less time to analyze the advisor's reports and recommendations in the context of their own adopted proxy voting guidelines to arrive at informed voting decisions. Time is already tight, particularly in the highly concentrated spring "proxy season," due to the limited period between a company's publication of the annual meeting proxy materials and annual meeting dates. Simply put, the proposed legislation is not constructive regulatory "reform," and is not supported by institutional investors.

Moreover, H.R. 4015 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 shareowner advocates should operate on a level playing field.

H.R. 4015 would also require the Securities and Exchange Commission (SEC) to assess the ability of proxy advisory firms to perform their duties and to assess the adequacy of proxy advisory firms' "financial and managerial resources."¹⁸

The entities that are in the best position to make assessments about whether a service provider – including proxy advisory firms – are adhering to contractual terms negotiated with clients are the clients themselves, not the government. Pension funds and other institutional investors that choose to purchase these services are sophisticated consumers who are fully capable of making prudent choices based on free-market principles.

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.¹⁹ CII and many institutional investors publicly supported that guidance.²⁰ 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. If the Committee is concerned about proxy advisory firms, we would respectfully suggest that the Committee request that the SEC brief the Committee on whether the 2014 guidance is being adequately followed and enforced.

If enacted, the proposed legislation would increase costs for pension plans and other institutional investors with no clear benefits. The costs could rise substantially if investors seek to maintain current levels of scrutiny and due diligence around proxy voting amid the exit of some or all proxy advisory firms from the business. These increased costs would also likely impair the ability of institutional investors to promote good corporate governance and accountability at the companies in which they own stock. Proxy advisory firms, while imperfect, play an important and useful role in enabling effective and cost-efficient independent research, analysis and

¹⁸ *Id.*

¹⁹ SEC Staff Legal Bulletin No. 20 (June 30, 2014), <https://www.sec.gov/interps/legal/cfs1b20.htm>.

²⁰ See Letter from Jeff Mahoney, General Counsel, CII, to The Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services et al. 5 (July 23, 2014) ("Consistent with our recommendation, the Guidance clarifies that investment advisers are not required to vote every proxy."),

https://www.cii.org/files/issues_and_advocacy/correspondence/2014/07_23_14_letter_Subcommittee_Capital_Markets.pdf.

informed proxy voting advice for large institutional shareholders, particularly since many funds hold shares of thousands of companies in their investment portfolios.

We believe that the cost estimate provided by the Congressional Budget Office (CBO) to the House Financial Services Committee in December 2017 underestimates the costs that this bill would impose through private-sector mandates.²¹ The CBO should analyze the probable effects of the proposal on competition, and the costs to investors if: (1) competition is reduced and the pricing power of a surviving proxy advisory firm is enhanced, and (2) if all present firms exit the market and the services they provided are no longer available, forcing individual investors to use internal resources not subject to the new regulatory mandate.

Finally, we note that in October 2017, the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its report to the President on “A Financial System that Creates Economic Opportunities, Capital Markets.”²² In that report, the Treasury found that “institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements.”²³ More importantly, the Treasury did not recommend any legislative changes governing the proxy advisory firm industry.²⁴ Contrary to H.R. 4015’s focus on government intervention, the Treasury recommended that any regulatory response *should promote free market principles*.²⁵

Cybersecurity

CII believes that cybersecurity is an integral component of a board’s role in risk oversight.²⁶ Directors have the authority, capacity and responsibility to make pivotal contributions in this area by ensuring adequate resources and management expertise are allocated to robust cyber risk management policies and practices, and ensuring disclosure fairly and accurately portrays material cyber risks and incidents.²⁷ To achieve these objectives, directors need to:

- Understand management’s cybersecurity strategy;
- Learn where cybersecurity weaknesses lie, and;
- Support informed, reasonable investment in the protection of critical data and assets.²⁸

Consistent with our view, we generally agree with SEC Chairman Jay Clayton that “in today’s world, companies must have adequate policies and procedures in place to ensure that they

²¹ Congressional Budget Office, H.R. 4015, Corporate Governance Reform and Transparency Act, <https://www.cbo.gov/publication/53377>.

²² U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Capital Markets 31 (Oct. 2017), <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>

²³ *Id.*

²⁴ *See id.* (“Treasury recommends further study and evaluation of proxy advisory firms, including regulatory responses to promote free market principles if appropriate.”).

²⁵ *See id.* (emphasis added).

²⁶ CII, Prioritizing Cybersecurity, Five Investor Questions for Portfolio Company Boards 2 (Apr. 2016), <https://www.cii.org/files/publications/misc/4-27-16%20Prioritizing%20Cybersecurity.pdf>.

²⁷ *Id.*

²⁸ *Id.*

respond appropriately to—and, where necessary, adequately disclosure—material cyber risks and incidents.”²⁹

On February 2018, the SEC issued a statement and interpretative guidance to assist public companies in preparing disclosures about cybersecurity.³⁰ Some investors believe the guidance is insufficient.³¹

S. 536³²

S. 536 directs the SEC to issue final rules requiring a registered issuer to:

- Disclose in its mandatory annual report or annual proxy statement whether any member of its governing body has expertise or experience in cybersecurity, including details necessary to describe fully the nature of that expertise or experience; and
- If no member has such expertise or experience, describe what other company cybersecurity steps were taken into account by the persons responsible for identifying and evaluating nominees for the governing body.³³

CII strongly supports the stated goal of the bill to “promote transparency in the oversight of cybersecurity risks at publicly traded companies.”³⁴ We are optimistic that, unlike H.R. 4015, S. 536 may have the potential of being pursued in a thoughtful and bi-partisan manner that is responsive to the views of investors.³⁵

Thank you for considering these views. CII would be very happy to discuss its perspective in more detail. I can be reached at jeff@cii.org or by telephone at (202) 822-0800.

Sincerely,



Jeff Mahoney
General Counsel

²⁹ Oversight of the U.S. Securities and Exchange Commission, Before the H. Comm. on Fin. Servs., 115th Cong. (June 21, 2018) (Testimony of Jay Clayton, Chairman, SEC at 8), <http://www.mondovisione.com/media-and-resources/news/testimony-on-oversight-of-the-us-securities-and-exchange-commission-sec-cha-1/>.

³⁰ Press Release 2018-22, SEC Adopts Statement and Interpretative Guidance on Public Company Cybersecurity Disclosures (Feb. 21, 2018), <https://www.sec.gov/news/press-release/2018-22>.

³¹ See, e.g., Hazel Bradford, Investors Pushing Harder for Cybersecurity Solution, P&I, Mar. 5, 2018 (“Mr. DiNapoli, the sole trustee of the \$209.1 billion New York State Common Retirement Fund, Albany, agrees that the latest SEC action fell short.”), <http://www.pionline.com/article/20180305/PRINT/180309912/investors-pushing-harder-for-cybersecurity-solution>.

³² S. 536, 115th Cong. (Mar. 7, 2017), <https://www.congress.gov/115/bills/s536/BILLS-115s536is.pdf>.

³³ See *id.* at § 2.

³⁴ *Id.*; Letter from Ken Bertsch, Executive Director, Council of Institutional Investors to The Honorable Jack Reed, United States Senate (July 7, 2017), https://www.cii.org/files/07_07_17%20letter%20to%20Senator%20Reed.pdf.

³⁵ See H.R. 4015, Final Vote Results for Roll Call 702 (more than 90% of House Democrats voted nay on H.R. 4015), <http://clerk.house.gov/evs/2017/roll702.xml>.

CC: The Honorable Dean Heller, Chairman, Subcommittee on Securities, Insurance, and Investment, Committee on Banking, Housing, and Urban Affairs
The Honorable Mark Warner, Ranking Member, Subcommittee on Securities, Insurance and Investment, Committee on Banking, Housing, and Urban Affairs
The Honorable Richard Shelby, Committee on Banking, Housing, and Urban Affairs
The Honorable Bob Corker, Committee on Banking, Housing, and Urban Affairs
The Honorable Patrick J. Toomey, Committee on Banking, Housing, and Urban Affairs
The Honorable Tim Scott, Committee on Banking, Housing, and Urban Affairs
The Honorable Ben Sasse, Committee on Banking, Housing, and Urban Affairs
The Honorable Tom Cotton, Committee on Banking, Housing, and Urban Affairs
The Honorable Michael Rounds, Committee on Banking, Housing, and Urban Affairs
The Honorable David Perdue, Committee on Banking, Housing, and Urban Affairs
The Honorable Thom Tillis, Committee on Banking, Housing, and Urban Affairs
The Honorable John Kennedy, Committee on Banking, Housing, and Urban Affairs
The Honorable Jerry Moran, Committee on Banking, Housing, and Urban Affairs
The Honorable Jack Reed, Committee on Banking, Housing, and Urban Affairs
The Honorable Robert Menendez, Committee on Banking, Housing, and Urban Affairs
The Honorable John Tester, Committee on Banking, Housing, and Urban Affairs
The Honorable Elizabeth Warren, Committee on Banking, Housing, and Urban Affairs
The Honorable Heidi Heitkamp, Committee on Banking, Housing, and Urban Affairs
The Honorable Joe Donnelly, Committee on Banking, Housing, and Urban Affairs
The Honorable Brian Schatz, Committee on Banking, Housing, and Urban Affairs
The Honorable Chris Van Hollen, Committee on Banking, Housing, and Urban Affairs
The Honorable Catherine Cortez Masto, Committee on Banking, Housing, and Urban Affairs
The Honorable Doug Jones, Committee on Banking, Housing, and Urban Affairs