Council of Institutional Investors®
The voice of corporate governance

Via E-Mail

September 25, 2020

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

*Re: File No. S7-06-20*

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors ("CII"). CII is a nonprofit, nonpartisan association of United States (U.S.) public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.[1]

This letter is in response to the Securities and Exchange Commission's (SEC or Commission) invitation to comment on its semiannual regulatory agenda (Agenda).[2] We commend the Commission for responding, in part, to our requests by advancing the "Division of Corporation Finance" agenda items on "Universal Proxy," and "Listing Standards for Recovery of Erroneously Awarded Compensation."[3]

In addition, we respectfully reiterate our requests that the Commission add to its "Division of Corporation Finance" agenda amendments to (1) Rule 10b5-1 trading plans and (2) Item 402(b)

[1] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.
[2] Regulatory Flexibility Agenda, Securities Act Release No. 10,769, Exchange Act Release No. 88,531, Investment Adviser Act Release No. 5,470, Investment Company Act Release No. 33,833, 85 Fed. Reg. 52,862 (Aug. 26, 2020), https://www.federalregister.gov/documents/2020/08/26/2020-16750/regulatory-flexibility-agenda.
[3] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa Countryman, Secretary, Securities and Exchange 1 (July 18, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/July%2018%202019%20SEC%20Reg%20Flex%20Letter%20Final(1).pdf ("We respectfully reiterate our requests that the following two individual agenda items currently listed under the "Division of Corporation Finance—Long Term Actions" be advanced to "Division of Corporation Finance— Final Rule Stage:" "Universal Proxy" and "Listing Standards for Recovery of Erroneously Awarded Compensation.").

of Regulation S-K to improve the information about the pay target metrics presented in the Compensation Discussion & Analysis (CD&A) section of the proxy statement.[4]
Finally, we commend the Commission for adding "Proxy Process Amendments" to its Division of Corporation Finance—Proposed Rule Stage."[5] We assume the project's omission from the federal register version of the Agenda was an oversight.[6]

In making these requests, we are mindful of the Commission's limited resources and believe our requests, the bases for which are described in more detail below, would have a positive impact on long-term investors.

**Universal Proxy**

CII agrees with most investors and "many panelists" at the SEC's November 15, 2018, public roundtable on the proxy process (Roundtable) who recommended the SEC finalize its 2016 proposal on Universal Proxy (2016 Proposal).[7] The 2016 Proposal is generally consistent with CII's membership approved policies.[8] Those policies state:

> 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.[9]

Events over the past year lend further support for the prompt issuance of the long-awaited final rule on universal proxy. Last September the SEC's Investor Advisory Committee (IAC) Investor-as-Owner Subcommittee recommended with overwhelming support that the "SEC should adopt its proposed '**universal proxy**' rule, with the modest changes that would be needed to address objections that have been raised to the proposal."[10]

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[4] *Id.* ("In addition, we respectfully request that the Commission add to its "Division of Corporation Finance—Long Term Actions" amendments to (1) Rule 10b5-1 trading plans and (2) Item 402(b) of Regulation S-K to improve the information about the pay target metrics presented in the Compensation Discussion & Analysis (CD&A) section of the proxy statement").
[5] *See, e.g.,* Cydney Posner, What's on the SEC's Spring 2020 RegFlex Agenda?, Cooley PubCo (July 9, 2020), https://cooleypubco.com/2020/07/09/secs-spring-2020-regflex-agenda/ ("**Proxy Process Amendments**—Corp Fin may recommend that the SEC propose amendments to the proxy rules to facilitate improvements in the shareholder voting and communication process, otherwise referred to as proxy plumbing issues. There has been substantial criticism of the current byzantine system of share ownership and intermediaries that has accreted over time").
[6] *See* 85 Fed. Reg. at 52,862-63.
[7] Adé Heyliger & Aabha Sharma, Key Takeaways from the SEC's Proxy Process Roundtable: Is Proxy Voting Reform on the Horizon?, JDSUPRA 2 (Nov. 20, 2018), https://www.jdsupra.com/legalnews/key-takeaways-from-the-sec-s-proxy-45650/; *see, e.g.*, U.S. Securities and Exchange Commission, Roundtable on the Proxy Process Transcript 70 (Nov. 15, 2018), https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf (panelist Brian L. Schorr recommending "the use of the universal proxy . . . [to] eliminate some of the problems that we're trying to tackle today").
[8] Council of Institutional Investors, Corporate Governance Policies § 2.2 Director Elections (updated Mar. 10, 2020), https://www.cii.org/files/03_10_20_corp_gov_policies(1).pdf.
[9] *Id.*
[10] Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee (IAC), Proposal for a Proxy Plumbing Recommendation 1 (Aug. 15, 2019), https://www.sec.gov/spotlight/investor-

At CII's Spring 2020 conference in March, Commissioner Roisman appeared to agree with the adoption of a universal proxy rule stating:

> I have been assessing our voting system from the perspective of how to best serve retail investors, I have come to believe the Commission should consider adopting a universal proxy rule. . . . There seems to be growing consensus that a universal proxy rule could provide benefits to everyone involved in a proxy contest, most importantly, the investors being solicited.[11]

Last month, a letter from 15 market participants including representatives from Wachtell, Lipton, Rosen & Katz, Broadridge Financial Solutions, CalSTRS, D.F. King, Wilson Sonsini Goodrich & Rosati, Trian Partners, and CII staff expressed support for the 2016 Proposal (UPWG Letter).[12] The UPWG Letter described the 2016 Proposal as "an important milestone . . . by establishing that under qualifying circumstances, the registrant proxy card and the dissident proxy card each must include all nominees and present them fairly."[13] While the UPWG Letter includes some suggestions on how to improve the 2016 Proposal,[14] in our view, all the suggestions had already been identified and appropriately addressed in the 2016 Proposal or related comment letters, and none of the suggestions are not an impediment to prompt issuance of a long-overdue final rule.

CII continues to believe that the SEC should promptly[15] adopt a final rule largely consistent with the 2016 Proposal.[16] Requiring the use a universal proxy for contested meetings would provide investors with the flexibility to vote for their choice of management and dissident nominees, potentially lowering the costs associated with proposing a nominee, and dramatically simplify the mechanics of the voting process for those high-profile meetings.[17]

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advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-the-us-proxy-system-090519.pdf.

[11] Commissioner Elad L. Roisman, Speech at CII Conference (Mar. 10, 2020), https://www.sec.gov/news/speech/speech-roisman-cii-2020-03-10.

[12] Letter from the Universal Proxy Group to William Hinman, Director of Corporation Finance, Securities and Exchange Commission 1, 3-4 (Aug. 6, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/UPWG%20final%20letter%20dated%208-6-20.pdf.

[13] *Id.* at 1.

[14] *See id.* at 1-3.

[15] *See, e.g.*, U.S. Securities and Exchange Commission, Roundtable on the Proxy Process Transcript at 77 (panelist Bruce H. Goldfarb stating: "we need to walk and chew gum at the same time[] I think we can do multiple things . . . [a]nd on universal proxy, the SEC put out a very good proposal two years ago, and I think . . . the work has already been done[] [s]o I don't think that needs to derail anything else that's happening").

[16] *See* Letter from Ken Bertsch, Executive Director, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 3 (Dec. 28, 2017) (providing extensive comments in response to the 2016 proposal and noting that "[w]ith minor enhancements, the proposed framework will provide for a constructive universal proxy regime that gives greater effect to existing shareholder rights"), https://www.cii.org/files/issues_and_advocacy/correspondence/2016/12_28_16_comment_letter_SEC_universal_proxy.pdf.

[17] *See, e.g.*, Glass Lewis, SEC Proxy Recommendations Include Universal Ballot and Vote Confirmation (Sept. 13, 2019), https://www.glasslewis.com/sec-proxy-recommendations-include-universal-ballot-and-vote-confirmations/ ("In Glass Lewis' view, implementing universal proxy would both enhance shareholder rights and simplify the mechanics of proxy voting).

**Listing Standards for Recovery of Erroneously Awarded Compensation**

CII continues to support prompt completed action on the SEC's required response to Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) entitled, "Recovery of Erroneously Awarded Compensation."[18] We note that Section 954 was responsive to the recommendations of the Investors' Working Group (IWG).[19]

In its seminal report on U.S. Financial Regulatory Reform, the IWG concluded:

> **Federal clawback provisions on unearned executive pay should be strengthened**. Clawback policies discourage executives from taking questionable actions that temporarily lift share prices but ultimately result in financial restatements. Senior executives should be required to return unearned bonus and incentive payments that were awarded as a result of fraudulent activity, incorrectly stated financial results or some other cause. The Sarbanes-Oxley Act of 2002 [(SOX)] required boards to go after unearned CEO income, but the Act's language is too narrow. It applies only in cases where misconduct is proven—which occurs rarely because most cases result in settlements where charges are neither admitted nor denied—and only covers CEO and CFO compensation. Many courts, moreover, have refused to allow this provision to be enforced via private rights of action.[20]

The SEC's proposed rule to implement Section 954 (2015 Proposal) is generally consistent with CII's membership approved policies.[21] Those policies state:

> Clawback policies should ensure that boards can refuse to pay and/or recover previously paid executive incentive compensation in the event of acts or omissions resulting in fraud, financial restatement or some other cause the board believes warrants recovery, which may include personal misconduct or ethical lapses that cause, or could cause, material reputational harm to the company and its shareholders. Companies should disclose such policies and decisions to invoke their application.[22]

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[18] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 954 (2010), https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

[19] S. Rep. No. 111-176, at 136 (Apr. 30, 2010), https://www.congress.gov/111/crpt/srpt176/CRPT-111srpt176.pdf. ("The Investor's Working Group wrote 'federal clawback provisions on unearned executive pay should be strengthened.'").

[20] Report of the Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 23 (July 2009), http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

[21] Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 9,861, Exchange Act Release No. 75,342, Investment Company Act Release No. 31,702, 80 Fed. Reg. 41,144 (proposed rule July 2015), https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.

[22] Council of Institutional Investors, Corporate Governance Policies § 5.7 Compensation Recovery.

Consistent with CII policies, we believe the final SEC rule should, as proposed,[23] 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.[24] As we explained in our comment letter to the SEC in response to the 2015 Proposal:

> 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.[25]

A broad clawback can be "a powerful tool for companies seeking to punish executives for wrongdoing"[26] In addition, we agree with legal experts that broad clawback arrangements may "keep executive officers focused on sound accounting company-wide."[27]

We note that as part of the Commission's recent order charging Super Micro Computer (SMC) and its former chief financial officer for widespread accounting violations, SMC's chief executive officer was required to reimburse the company $2.1 million in stock profits pursuant to the much narrower clawback provision of SOX.[28] The SEC's Division of Enforcement staff described the result as '"hold[ing] executives accountable when they exploit insufficient internal controls."'[29]

We acknowledge SEC Chairman Jay Clayton's observation that "several companies . . . [have clawback] policies [that] go beyond what would be required under Dodd-Frank."[30] And that the

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[23] *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").
[24] *See, e.g.*, 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.
[25] *Id.* (footnotes omitted).
[26] *See, e.g.*, Jef Feeley & Anders Melin, Hertz Seeks $70M in Clawbacks Tied to Accounting Scandal, Acct.Today, Apr. 1, 2019, https://www.accountingtoday.com/articles/hertz-seeks-70m-in-clawbacks-tied-to-accounting-scandal.
[27] *See, e.g.*, Financial CHOICE Act of 2017, Hearing Before the H. Comm. on Fin. Servs., 115th Cong. (Apr. 26, 2017) (testimony of Michael S. Barr, The Roy F. and Jean Humphrey Proffitt Professor of Law, University of Michigan Law School at 15) (on file with CII).
[28] *See* Press Release, U.S. Securities and Exchange Commission, SEC Charges Super Micro and Former CFO in Connection with Widespread Accounting Violations (Aug. 25, 2020), https://www.sec.gov/newms/press-release/2020-190 ("Super Micro's CEO, Charles Liang, while not charged with misconduct, is required to reimburse the company $2.1 million in stock profits that he received while the accounting errors were occurring, pursuant to the clawback provision of the Sarbanes-Oxley Act.").
[29] *Id.*
[30] U.S. Securities and Exchange Commission, Chairman Jay Clayton, Testimony on "Oversight of the U.S. Securities and Exchange Commission," Before the Comm. on Fin. Servs., U.S. H.R. at n.50 (June 21, 2018), https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission; *see* Lane Ringlee & John Ellerman, Recent SEC Action – Clawbacks and Proxy Advisory Firm Regulations (Aug. 12, 2020), https://www.paygovernance.com/viewpoints/recent-sec-actions-clawbacks-and-proxy-advisory-firm-regulations ("many clawback policies adopted by companies over the past several years cover a broader group of executives and include trigger events that are more expansive than the proposed rules"); Jonathan Ocker et al., The State of Play on Clawbacks and Forfeitures Based on Misconduct, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (July 7, 2019), https://corpgov.law.harvard.edu/2019/07/07/the-state-of-play-on-clawbacks-and-forfeitures-based-on-misconduct/

adoption of broader clawback policies has been encouraged by institutional investors, including CII members.[31] We, however, note that many existing clawback policies do not require fault; a deficiency that would be corrected by adopting the 2015 Proposal.[32] Moreover, some widely held, prominent, public corporations have not adopted any form of clawback.[33]

We continue to believe there are a multitude of potential benefits to long-term investors from the SEC requiring *all* companies to adopt, at a minimum, clawback policies consistent with the 2015 Proposal mandated by the U.S. Congress.[34] While it is unclear why the SEC has indicated that they plan to issue a second proposal rather than finalize the 2015 Proposal,[35] what is more disappointing is that the SEC has taken no action for more than five years on an Agenda item that was supported by most long-term investors and mandated by the U.S. Congress.

**Rule 10b5-1 Trading Plans**

For the benefit of both institutional and retail investors, CII continues to believe the Commission should make a priority of proposing amendments to improve Rule 10b5-1 trading plans.[36]

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("While many companies are adopting or modifying their existing clawback policies in a manner intended to meet the proposed Dodd-Frank clawback rules, some companies also go beyond these minimum requirements and include additional clawback triggers in their clawback policies and forfeiture provisions, such as detrimental behavior and violation of restrictive covenants"); Proxy Process and Rules: Examining Current Practices and Potential Changes: Hearing before the S. Comm. on Banking, Hous. & Urban Affairs, 115th Cong. (Dec. 6, 2018) (statement of Michael Garland, Assistant Comptroller, for Corp. Governance and Responsible Inv., In the Office of the N.Y.C. Comptroller Scott Stringer at 8), https://www.banking.senate.gov/imo/media/doc/Garland%20Testimony%2012-6-18.pdf (indicating that the successful negotiation of a broad clawback policy at Wells Fargo "enabled the Wells Fargo Board of directors to announce in September 2016 that it would recoup $60 million from two senior executives in order to hold them financially accountable for the fake account scandal that involved the loss of jobs by 5,300 lower-level employees and cost Wells Fargo $185 million in fines and penalties"); Kathryn Neel et al., The Business Case for Clawbacks, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (May 6, 2018), https://corpgov.law.harvard.edu/2018/05/06/the-business-case-for-clawbacks/ (listing Cognizant Technology Solutions, Wells Fargo, Zions Bancorp, and EBay as companies that have adopted "detrimental conduct" clawback policies).

[31] *See, e.g.*, Jonathan Ocker et al., The State of Play on Clawbacks and Forfeitures Based on Misconduct, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. ("Big investment funds (e.g., BlackRock and CalPERS) are increasingly encouraging companies to expand these clawback policies to provide discretion covering management misconduct that results in significant reputational harm or adverse publicity unrelated to a financial restatement and executives who supervise employees who engaged in misconduct.").

[32] *Id.* (a survey of ten major Silicon Valley companies found that six have clawback policies that "may be triggered by financial restatements involving management misconduct . . . .").

[33] *Id.* (a survey of ten major Silicon Valley companies found "Alphabet and Facebook" do not have clawback policies).

[34] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa Countryman, Secretary, Securities and Exchange at 1 ("we believe there are a multitude of potential benefits to long-term investors from the SEC requiring *all* companies to adopt, at a minimum, clawback policies consistent with the 2015 Proposal and the Dodd Frank mandate by the U.S. Congress").

[35] 85 Fed. Reg. at 52,864 (referencing a "Second PPRM [with a date of] 10/00/20").

[36] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 13 (July 11, 2018), https://www.cii.org/files/July%2011%202018%20SEC%20Reg%20Flex%20Letter%20Final.pdf ("Finally, for the benefit of both institutional and retail investors, we continue to believe the Commission should make a priority of proposing amendments to improve Rule 10b5-1 trading plans.").

For years, we have heard and read accounts about corporate insiders violating the spirit of the SEC's Rule 10b5-1,[37] apparently in at least some cases in efforts to provide cover for improper stock trades while possessing material non-public information.[38] *The Wall Street Journal* published a series of articles in 2012 that highlighted suspiciously fortuitous trading patterns under Rule 10b5-1 plans adopted by corporate insiders.[39] Empirical research by academics has found similar results[40] suggesting that "that trades that should have resulted in insider trading liability have escaped scrutiny."[41]

In December 2012, at the recommendation and with the assistance of a prominent corporate/securities lawyer, CII submitted a rulemaking petition to the SEC recommending improvements to Rule 10b5-1.[42] Those improvements were specifically designed to limit the opportunity for executives to continue to abuse the rule and are reflected in our membership approved policies.[43]

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[37] Trading "On the Basis Of" Material Nonpublic Information in Insider Trading Cases, 17 C.F.R. § 240.10b5-1 (Aug. 2000), *available at* https://www.law.cornell.edu/cfr/text/17/240.10b5-1.

[38] *See, e.g.*, Craig M. Scheer, Rule 10b5-1 Trading Plans in the Current Environment: The Importance of Doing it Right, Bus. L. Today (Sept. 19, 2018), https://businesslawtoday.org/2013/02/rule-10b5-1-trading-plans-in-the-current-environment-the-importance-of-doing-it-right/ ("Critics have long viewed the rule as creating an opportunity for abuse, claiming that some insiders may in fact be aware of material non-public information at the time plans are established and that the rule can be used to provide cover for improper trades.").

[39] Jean Eaglesham & Rob Barry, Trading Plans Under Fire, Wall. St. J., Dec. 13, 2012, https://www.wsj.com/articles/SB10001424127887324296604578177734024394950 ("the SEC is facing mounting pressure to tighten its rules, following a[n] . . . investigation that found profitable and well-timed trades by more than 1,400 executives); Justin Lahart, Timing Is Everything for Insider Sales, Wall. St. J., Nov. 28, 2012, https://www.wsj.com/articles/SB10001424127887324020804578147261230632772 ("There is substantial wiggle room within 10b5-1 plans—for example, their existence doesn't have to be disclosed, and they can be canceled or changed without disclosure, as well."); Susan Pulliam & Rob Barry, Executives' Good Luck in Trading Own Stock, Wall. St. J., Nov. 27, 2012, https://www.wsj.com/articles/SB10000872396390444100404577641463717344178 (initial reporting on investigation finding that more than 1,400 executives, including some with 10b5-1 plans, had made usually beneficial trades).

[40] *See* John Shon & Stanley Veliotis, Insiders' Sales Under Rule 10b5-1 Plans and Meeting or Beating Earnings Expectations, 59(9) Mgmt. Sci. iv (Sept. 2013), https://pubsonline.informs.org/doi/abs/10.1287/mnsc.1120.1669?journalCode=mnsc. ("One interpretation of our results is that CEOs and CFOs who sell under these plans may be more likely to engage in strategic behavior to meet or beat expectations in an effort to maximize their proceeds from plan sales."), https://pubsonline.informs.org/doi/abs/10.1287/mnsc.1120.1669?journalCode=mnsc.; *see also* Cydney Posner, Blog: Clayton Advocates "Good Corporate Hygiene" When It Comes To Material Inside Information, JDSUPRA (Sept. 23, 2020), https://www.jdsupra.com/legalnews/blog-clayton-advocates-good-corporate-66084/ ("Notably, 10b5-1 plans became a bit suspect when academic studies uncovered a statistical link between the timing of executive sales under Rule 10b5-1 plans and negative corporate news, finding that executives using 10b5-1 plans generated significantly better returns than other executives at the same company.").

[41] Alfred L. Fatale III & Lisa Strejlau, Analysis, The Time has Come to Address Rule 10b5-1 Trading Plans and Their Shortcomings, N.Y.L.J. (Mar. 6, 2019), https://www.law.com/newyorklawjournal/2019/03/06/the-time-has-come-to-address-rule-10b5-1-trading-plans-and-their-shortcomings/.

[42] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Elisse B. Walter, Chairman, U.S. Securities and Exchange Commission (Dec. 28, 2012), http://www.cii.org/files/issues_and_advocacy/correspondence/2012/12_28_12_cii_letter_to_sec_rule%20_10b5-1_trading_plans.pdf.

[43] *Id.* at 3 (proposed improvements include "imposing a minimum period between the adoption of a Rule 10b5-1 plan and the execution of trades pursuant to such plan, . . . restricting plan modifications and cancellations . . . [and] making boards explicitly responsible for the oversight of Rule 10b5-1 plans"); *see* Council of Institutional Investors, CII Policies, Statement on Stock Sales by Insiders (adopted Mar. 10, 2020),

Despite our repeated requests, the common-sense improvements to Rule 10b5-1 that we first recommended in 2012 have not been adopted.[44] As a result, gaping loopholes in the rule remain that we believe will likely continue to be subject to periodic abuse through "successful manipulation of trading plans."[45] The most recent reported example of a potential high-profile abuse of Rule 10b5-1 was at Moderna, Inc:

> [A]fter the company stock (NASDAQ:MRNA) increased more than 24% on the news that the Cambridge, Mass., company was making progress toward a COVID-19 vaccine, certain executives reportedly altered their 10b5-1 trading plans to increase the number of company stocks they could sell, according to the memo. Moderna's CEO sold 72,000 company shares for a $4.8 million profit, and its president altered his trading plan to allow him to sell $1.9 million in company shares.[46]

On September 14, 2020, in a letter to the Honorable Brad Sherman of the U.S. House of Representatives, SEC Chairman Clayton acknowledged concerns about how some corporations are implementing Rule 10b5-1 stating (Chairman Letter):

> [T]here are practices that, while they may be consistent with law and regulation, raise questions of interest alignment and fairness, including, in particular, issues that arise when plans are implemented, amended or terminated and trading occurs (or does not occur) around those events. I believe that companies should strongly consider requiring all Rule l0b5-1 plans for senior executives and board members to include mandatory seasoning, or waiting periods after adoption, amendment or termination before trading under the plan may begin or recommence. In my view, these required seasoning periods are appropriate between the establishment of a plan and the date of the initial trade, as well as between any modification, suspension or termination of a plan and the resumption of trading or entry into a new plan. Such seasoning periods not only help demonstrate that a plan was executed in good faith, but they also can bolster investor confidence in management teams and in markets generally.[47]

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https://www.cii.org/insider_stock_sales_statement ("For Rule 10b5-1 plans to fulfill their legitimate purpose, they should be: publicly disclosed; adopted when the participant is not in possession of material, non-public information; inactive for at least three months following adoption; and ineligible for substantive modification.").

[44] *See, e.g.*, Cydney Posner, Blog: Clayton Advocates "Good Corporate Hygiene" When It Comes To Material Inside Information, JDSUPRA ("No action to amend the Rule was taken by the SEC at the time.").

[45] Alfred L. Fatale III & Lisa Strejlau; *see, e.g.*, Ken Kam, 2 CEOs Who Have Not Earned My Trust, Forbes, Feb. 17, 2019, https://www.forbes.com/sites/kenkam/2019/02/17/2-ceos-who-have-not-earned-my-trust/#7a8dbec0337c ("the fact is [in October 2017, after changing his 10b5-1 trading plan, the former chief executive officer of Intel Corp. Brian] Krzanich sold every share [of Intel stock] he could and still remain CEO about a month before the security vulnerabilities of Intel's processors became public knowledge").

[46] Mari Serebroy, U.S. Lawmakers Look to Close Trading Loopholes, BioWorld (Sept. 17, 2020), https://www.bioworld.com/articles/497912-us-lawmakers-look-to-close-trading-loopholes.

[47] Letter from Jay Clayton, Chairman, Office of Chairman, United States Securities and Exchange Commission to The Honorable Brad Sherman, U.S. House of Representatives 2 (Sept. 14, 2020) (emphasis added), https://www.sec.gov/files/clayton-letter-to-chairman-sherman-20200914.pdf.

Several days later in testimony before Representative Sherman's Investor Protection, Entrepreneurship, and Capital Markets Subcommittee of the Committee on Financial Services, Jill E. Fisch of the University of Pennsylvania Law School described the following shortcomings with Rule 10b5-1 trading plans:

> A shortcoming of the existing regulatory structure is that current law does not require corporate executives to disclose the existence of their 10b5-1 trading plans. Nor are executives required to disclose if they modify or terminate an existing plan. In addition, current law allows executives, in some cases, to modify existing trading plans on the basis of inside information without facing liability for insider trading. Specifically, an executive who learns about positive news can terminate his or her previously established decision to sell, based on that news. Because the termination does not constitute the purchase or sale of a security, but rather refraining from trading, technically it is not insider trading. It appears that some executives, in light of market developments may have decided not to trade in accordance with their existing 10b5-1 plans. Although individual issuers may establish procedures governing when or how executives are permitted to do so, such procedures are not required by existing law.[48]

We understand from the Chairman Letter that the SEC staff is currently "working on a report in response to a directive in the Joint Explanatory Statement accompanying the FY 2020 FSGG appropriations act on the growth share repurchases, and are considering this and other issues relating to Rule l0b5-1 plans as part of that report."[49] While we look forward to reading the referenced report, we are believe the evidence of Rule 10b5-1 abuses and the existence of cost-effective solutions to address those abuses have long been clear. The Commission should promptly propose amendments to Rule 10b5-1 consistent with our petition and membership approved policies.

**CD&A Pay Target Metrics**

CII believes that the Commission should make a priority of proposing amendments to insure that public companies explain why and how they use non-standard metrics to determine Chief Executive Officer (CEO) pay.[50]

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[48] Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic, Before the H. Subcomm. on Inv. Prot., Entrepreneurship, & Capital Mkt. of the Comm. on Fin. Serv., 116 Cong. (Sept. 17, 2020) (testimony of Jill E. Fisch, Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School at 5), https://docs.house.gov/meetings/BA/BA16/20200917/111013/HHRG-116-BA16-Wstate-FischJ-20200917.pdf.

[49] Letter from Jay Clayton at 2.

[50] Press Release, Council of Institutional Investors, Leading Investor Group Petitions SEC to Require Clear Disclosure on CEO Pay Targets (Apr. 29, 2019), https://www.cii.org/nongaapdisclosure ("Institutional investors say it's time for the Securities and Exchange Commission (SEC) to ensure that public companies explain why and how they use non-standard metrics to determine CEO pay.").

In April 2019 we submitted a rulemaking petition specifically asking the SEC amend Item 402(b) of Regulation S-K[51] to require companies in their proxy statements to (1) explain why they are using metrics other than generally accepted accounting principles (GAAP) in their CD&A for setting executive compensation and (2) provide a quantitative reconciliation of such metrics to their GAAP financials (or hyperlink to such a reconciliation in another document filed with the SEC).[52]

The problem, as MIT Sloan School of Management Senior Lecturer Robert C. Pozen and SEC Commissioner Jackson explain in their *Wall Street Journal* op-ed: "The SEC's disclosure rules have not kept pace with changes in compensation practices, so investors cannot easily distinguish between high pay based on good performance and bloated pay justified by accounting gimmicks."[53]

It used to be the case that non-GAAP metrics were the exception in compensation committee reports, but now they have become the rule.[54] As discussed in a blog by Olga Usvyatsky of Audit Analytics, there are at least two problems when companies use non-GAAP metrics for compensation purposes:

> First, the figures don't need to be reconciled to GAAP numbers. This means that investors have little visibility into how the metrics are calculated and which expenses were taken out. Second, some firms will double-adjust executive

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[51] Executive Compensation, 17 C.F.R. § 229.402(b) (Sept. 2006), *available at* https://www.law.cornell.edu/cfr/text/17/229.402 (Instruction 5 states: "Disclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G (17 CFR 244.100 - 102) and Item 10(e) (§ 229.10(e)); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statement.").

[52] *See* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission 1 (Apr. 29, 2019), https://www.cii.org/Files/issues_and_advocacy/correspondence/2019/20190426%20CII%20Petition%20revised%20on%20non-GAAP%20financials%20in%20proxy%20statement%20CDAs.pdf.

[53] Robert J. Jackson Jr. & Robert C. Pozen, Opinion/Commentary, Executive Pay Needs a Transparent Scorecard, Wall St. J, Apr. 10, 2019, https://www.wsj.com/articles/executive-pay-needs-a-transparent-scorecard-11554936540?mod=searchresults&page=1&pos=1; *see* Nicholas M. Guest et al., High Non-GAAP Earnings Predict Abnormally High CEO Pay (Jan. 2, 2019) (unpublished paper), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3030953 ("our evidence suggests large non-GAAP earnings adjustments influence some boards of directors in approving a level of CEO pay that is otherwise not supported by the firm's stock price or GAAP earnings performance."); Robert C. Pozen & S.P. Kothari, Executive Compensation, Decoding CEO Pay, Harv. Bus. Rev. (July-Aug. 2017), https://hbr.org/2017/07/decoding-ceo-pay (research suggesting that companies report inflated pro forma numbers in their proxy statements to rationalize overly generous executive compensation and recommending that "all exclusions of GAAP expenses should be justified and quantified").

[54] *See* Olga Usvyatsky, Pros and Cons of Using Non-GAAP Metrics for Executive Compensation, Including ESG Considerations, Audit Analytics (June 11, 2019), https://blog.auditanalytics.com/pros-and-cons-of-using-non-gaap-metrics-for-executive-compensation-including-esg-considerations/ (identifying a 50% increase in the use of non-GAAP metrics for executive compensation in proxy statements); Brian Croce, CII Urges SEC to Require Clear Disclosure of Executive Pay, P&I, Apr. 29, 2019, https://www.pionline.com/article/20190429/ONLINE/190429852/cii-urges-sec-to-require-clear-disclosure-on-ceo-pay ("'It used to be case that non-GAAP metrics were the exception in compensation committee reports but now they've become the rule,' said Mr. Pozen").

> compensation metrics by identically labeling metrics in both earnings releases and executive pay but calculating the metrics differently.
>
> There is limited transparency for investors and analysts when metrics are double-adjusted, and this is especially troubling if companies wouldn't be able to reach their C-suite compensation targets without double-adjusting the numbers. In 2018, about 30% of the S&P500 companies used metrics that were double-adjusted.[55]

Some might argue that our rulemaking petition is unnecessary because companies will voluntarily improve their proxy statements disclosures to include a quantitative reconciliation or a hyperlink to a quantitative reconciliation in another SEC filing. In anticipation of that argument, we reviewed the 2020 proxy statements of the seven companies we highlighted in our petition as examples of companies in need of better non-GAAP disclosure: Abbott Laboratories (Abbott), Advanced Micro Devices, Inc., Altice USA, Inc., Cisco, Cogent Communications Holdings, Oracle, and Revlon.[56] Per our review, we found that *none* of the seven companies had provided a quantitative reconciliation or a hyperlink to a quantitative reconciliation in 2020 proxy statements.[57]

Perhaps most notable of the seven companies was Abbott. The Vermont Pension Investment Committee (Investment Committee) submitted a shareholder proposal urging the "Board of Directors . . . adopt a policy that when the Company adjusts or modifies any generally accepted accounting principles . . . financial performance metric for determining senior executive compensation, the Compensation Committee's Compensation Discussion and Analysis shall include a specific explanation of the Compensation Committee's rationale for each adjustment *and a reconciliation of the adjusted metrics to GAAP*."[58]

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[55] Olga Usvyatsky; *see, e.g.*, Drew Bernstein, Marcum Bernstein & Pinchuk, Has Non-GAAP Reporting Become an Accounting Chasm?, CFO (Sept. 23. 2019), https://www.cfo.com/gaap-ifrs/2019/09/has-non-gaap-reporting-become-an-accounting-chasm/ ("if boards decide to provide incentive compensation to management or employees on the basis of non-GAAP they should be able to clearly explain why this is a superior metric to drive value creation and precisely what adjustments will be made to GAAP results").

[56] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission at 3-4 n.7.

[57] Abbott Laboratories, Schedule 14A at 38 (Mar. 13, 2020), https://sec.report/Document/0001047469-20-001466/ (various "adjusted" measures); Advance Micro Devices, Inc., Schedule 14A at 41 (May 7, 2020), *available at* https://www.marketwatch.com/investing/Stock/amd/SecFilings?subview=secarticle&sid=373&guid=14033480&type=313 (adjusted non-GAAP net income and adjusted free cash flow); Altice USA, Inc., Schedule 14A at 19 (Apr. 24, 2020), https://sec.report/Document/0001628280-20-005457/ (Adjusted EBITDA and Capex Adjusted EBITDA); Cisco, Notice of Annual Meeting of Shareholders and Proxy Statement 27 (Oct. 18, 2019), https://www.cisco.com/c/dam/en_us/about/annual-report/cisco-proxy-statement-2019.pdf (adjusted revenue and adjusted operating income); Cogent Communications Holdings, Inc., Schedule 14A at 25 (May 6, 2020), *available at* https://www.marketwatch.com/investing/Stock/ccoi/SecFilings?subview=secarticle&sid=1949137&guid=14000964&type=313 (("adjusted EBITDA") (as defined in the Company's earnings releases)"); Oracle Corporation, Schedule 14A at 36 (Sept. 27, 2019), https://www.sec.gov/Archives/edgar/data/1341439/000119312519257430/d755300ddef14a.htm ("(non-GAAP pre-tax profit")); Revlon, Inc., Schedule 14A (Apr. 22, 2020), https://sec.report/Document/0001140361-20-009411/ (includes no discussion of GAAP or non-GAAP targets).

[58] Abbott Laboratories, Schedule 14A at 74 (emphasis added).

In their supporting statement the Investment Committee argued:

> We believe that the Company's explanation on page 33 of 2019 Proxy Statement for using GAAP-adjusted metrics for executive pay was vague and unsatisfactory. The Company stated that ''Officer financial goals are based on adjusted measures that the Committee believes more accurately reflect the results of our ongoing operations and are determined based on the expected market growth of the businesses and markets in which we compete.''[59]

The Board of Directors of Abbott recommended a vote against the proposal stating:

> The use of non-GAAP financial metrics when evaluating performance is consistent with the way many S&P 500 companies' report on management's performance for purposes of determining compensation. . . .
>
> . . . the proxy statement (pg. 36) describes why the Compensation Committee has chosen to use adjusted metrics rather than GAAP metrics as part of Abbott's compensation philosophy. . . . Preparing a reconciliation that neither increases shareholder value nor adds to shareholder understanding wastes corporate time and resources.[60]

More than 30% of Abbott's shareholders voted in favor of the proposal.[61] It is unclear to us why corporate time and resources would be wasted by simply including a hyperlink in the proxy statement to a quantitative reconciliation of the non-GAAP metrics as requested by many of Abbotts' shareowners. We continue to believe that clarity on the financial criteria for executive compensation payouts is critical in the proxy statement because that is what shareholders review when deciding how to cast advisory votes on executive compensation, which occurs annually at most public companies.[62]

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[59] *Id.*
[60] *Id.* at 75.
[61] *See, e.g.*, James R, Copeland, Commentary, Proxy Monitor 2020: Abbott Labs, Boeing, IBM, J&J, and More (May 5, 2020), https://www.manhattan-institute.org/proxy-monitor-2020-abbott-labs-boeing-ibm-jj-and-more ("Item 4 – GAAP Financial Performance Metrics Disclosure (Vermont Pension Investment Committee) – 30.76% Voting in Favor").
[62] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa Countryman, Secretary, Securities and Exchange at 10 ("Clarity on financial criteria for payouts is critical in the proxy statement because that is what shareholders review when deciding how to cast advisory votes on executive compensation, which occur annually at most companies.").

**Proxy Process Amendments**

As indicated, at a meeting in September 2019, the IAC Investor-as-Owner Subcommittee recommended with overwhelming support that the SEC should adopt the 2016 Proposal with the modest changes.[63] Other approved recommendations included:

- The SEC should require end-to-end vote confirmations to end-users of the proxy system, potentially commencing with a pilot involving the largest companies;
- The SEC should require all involved in the system to cooperate in reconciling vote-related information, on a regular schedule, including outside specific votes, to provide a basis for continuously uncovering and remediating flaws in the basic "plumbing" of the system . . . .[64]

Four months later, when no action had been taken on any of the three recommendations, the IAC Investor-as-Owner Subcommittee issued another recommendation stating:

- Revisit Priorities. We reiterate our belief that the PA/SP actions simply do not address the most serious issues in the current pr system – such as **counting votes correctly**. We believe it critical that the SEC take up end-to-end vote confirmations, reconciliations, and universal proxies. Despite inclusion in the SEC's overall proxy system agenda, despite our previous recommendations, no formal guidance or rulemaking regarding proxy plumbing yet have been published by the SEC, and the SEC has not moved to finalize its good 2016 proposal on universal proxies.[65]

CII agrees. As then CII Executive Director Ken Bertsch stated in a press release issued last January in response to the SEC's proposed rules for proxy advise and shareholder proposals:

> CII believes the SEC should be tackling urgent obstacles in the proxy voting infrastructure. **"The SEC has put the cart before the horse," Bertsch said. "The SEC's first priority should be to fix the creaky proxy plumbing—the nuts and bolts of the ways that proxy cards are solicited and votes are counted."** He noted that at the SEC's November 2018 roundtable on the proxy process, there was striking unanimity among participants that modernizing the proxy infrastructure was the most urgent reform**. "Putting roadblocks in the way of shareholder voting in a system that does not deliver accurate vote counts does not make sense."**[66]

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[63] Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee (IAC), Proposal for a Proxy Plumbing Recommendation at 1.
[64] *Id.* at 1.
[65] Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee (IAC), Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals on Proxy Advisors and Shareholder Proposals 1-2 (Jan. 16, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-proxy-advisors-shareholder-proposals.pdf.
[66] Press Release, Council of Institutional Investors, Leading Investor Group Blasts SEC's Proposed Rules for Proxy Advice and Shareholder Proposals (Jan. 31, 2020), https://www.cii.org/jan2020secletters.

While we strongly opposed the Commission's proposals and final rules on proxy advice[67] and shareholder proposals,[68] we are hopeful that the SEC will now focus its rulemaking on what it should have been working on all along—proxy plumbing. And after promptly issuing a final rule on universal proxies, we believe the next the logical steps should include rulemaking to (1) require end-to-end vote confirmations; (2) require all parties involved in the system to cooperate in reconciling ownership and voting information; and (3) require or permit public company adoption of a system of traceable shares.[69]

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Thank you for consideration of our views. If we can answer any questions or provide additional information on the Commission's regulatory agenda, please do not hesitate to contact me.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

[67] Press Release, Council of Institutional Investors, Leading Investor Group Dismayed by SEC Proxy Advice Rules (July 22, 2020), https://www.cii.org/july22_sec_proxy_advice_rules.
[68] Press Release, Council of Institutional Investors, SEC Muzzles the Voice of Investors by Raising the Bar on Shareholder Proposals (Sept. 23, 2020), https://www.cii.org/sept23_sec_muzzles.
[69] *See, e.g.*, PETITION OF COUNCIL OF INSTITUTIONAL INVESTORS FOR REVIEW OF AN ORDER, ISSUED BY DELEGATED AUTHORITY, GRANTING APPROVAL OF A PROPOSED RULE 11 (Sept. 8, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/20200908%20Letter%20to%20SEC%20w%20attachments.pdf ("The Council believes – and has long believed – that traceability problems of the sort raised here should impel the Commission to update its "proxy plumbing" regulations before any liberalization of direct listing regulations"); *see generally* Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee (IAC), Proposal for a Proxy Plumbing Recommendation at 5-6 (describing comprehensive reform through the use of improved technologies to create a platform or system for tracking ownership and voting of shares).