MEMORANDUM

TO:	File No. S7-12-11 File No. S7-07-13 File No. 4-637
FROM:	Office of the Chair
DATE:	July 20, 2015
SUBJECT:	Meeting with representatives from Public Citizen

On July 17, 2015, Buddy Donohue, Chief of Staff, and Tamara Brightwell, Senior Advisor to Chair White, met with Lisa Gilbert and Bartlett Naylor of Public Citizen to discuss, among other matters, a petition on corporate political spending and the Commission's rulemakings to implement Section 953(b) and Section 956 of the Dodd-Frank Act.

May 27th, 2015

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Chair Mary Jo White:

We the undersigned, all former Commissioners and Chairs of the Securities and Exchange Commission (SEC), write in support of petition 4-637 ("to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities").

Petition 4-637 was submitted on August 3, 2011 by a committee of distinguished and nationally recognized law professors specializing in securities law and practice. They sought mandatory disclosure by public companies of corporate political spending, an issue of paramount public interest and growing concern to investors.

The petition has received a record-breaking 1.2 million supportive comments, illustrating the wide-spread importance of and need for action by the Commission to compel disclosure of political activities.

Despite the Supreme Court's decision in Citizens United in 2010, allowing corporations greater freedom to spend shareholder money to influence politics, there have still been no new rules or procedures established to ensure that shareholders – those who actually own the wealth of corporations – are informed of decisions on spending their money on politics.

This lack of regulation is in direct conflict with one of the essential building blocks supporting the opinion in the case. It's author, Mr. Justice Anthony Kennedy, justified permitting corporate political activities in large part on the expectation that shareholders and citizens would be informed of what those activities entailed. Thus, writing for the Court, he said:

"A campaign finance system that pairs corporate independent expenditures with effective disclosure has not existed before today. With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions…. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits, and citizens can see whether elected officials are in the pocket of so-called moneyed interests."

To date, the Court's expectation of disclosure, which can only be assured by SEC rule, has been denied. It is now five years since Citizens United and almost four years since Petition 4-637 was filed. The Commission's inaction is inexplicable. Its failure to act offends not only us, who are alumni of this agency struggling to retain our deep pride of association, but investors and the professionals who serve them. And it flies in the face of the primary mission of the Commission, which has since 1934 been the protection of investors. To use a metaphor, mandatory disclosure of corporate political activities should be a "slam dunk" for the Commission.

Sincerely,

William Henry Donaldson, 27th Chairman of the U.S. Securities and Exchange Commission, serving from February 2003 to June 2005 (R)

Arthur Levitt, 25th Chairman of the U.S. Securities and Exchange Commission, serving from 1993-2001 (D)

Bevis Longstreth, 60th Commissioner of the Securities and Exchange Commission, serving from 1981 to 1984 (D)

Janet Cowell
State Treasurer
North Carolina

Seth Magaziner
State Treasurer
Rhode Island

James McIntire
State Treasurer
Washington

Beth Pearce
State Treasurer
Vermont

Ted Wheeler
State Treasurer
Oregon

April 21, 2015

Mr. Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. 4-637, Committee on Disclosure of Corporate Political Spending, Petition for Rulemaking

Dear Secretary Fields:

As State Treasurers we have an obligation to make sure public funds are invested responsibly and accountably. The last election underscored a persistent flaw in our investment system – anonymous corporate political spending. As elected officials representing funds with assets under management totaling more than $300 billion, we call on the Commission to stand up for shareholders by embracing disclosure for all publicly traded corporations.

Secret political spending continues to be a top issue in the investment world. Since the petition to add political spending to the list of information available to shareholders was filed in 2011, the Commission received well over a million comments on the petition. And the number one shareholder proposal to American companies each of the past three years has been disclosure of political and lobbying activities. As shareholders representing hundreds of billions of dollars in funds, we frequently vote on those proposals in support of disclosure that could have bearing on the company's bottom line.

In the absence of action on the petition over the past three years, the trend continues to be toward greater accountability. In addition to successful shareholder activism, many companies have voluntarily agreed to disclose political spending. A recent survey of the top 300 companies in the S&P 500 found that 61% of companies disclose direct political spending and 43% disclose payments made to trade associations that engage in political spending.[1] The sunlight is steadily expanding, prompting the question: when will the SEC realize the shift and turn the lights on for all companies?

Amid the encouraging signs are grim realities about the need for comprehensive reform. The patchwork adoption of various disclosure policies leaves shareholders like us with a complex system of partial and disjointed information to consider. This has a substantial financial implication. After last November's

[1] Freed, Bruce et al. "The 2014 CPA-Zicklin Index of Corporate Political Disclosure and Accountability: How Leading Companies are Making Political Disclosure a Mainstream Practice." Center for Political Accountability 2014.

election, the Center for Responsive Politics noted a jump in dark money spending from $135 million to $170 million since the previous mid-term election. Far too many companies can cloak donations from shareholders behind the anonymous 501(c)(4) groups and other intermediaries that have grown in prominence the past several election cycles. A comprehensive system of disclosure is needed to complete the shift towards disclosure to all companies and along a uniform structure.

Respectfully,

Janet Cowell

Janet Cowell, State Treasurer
North Carolina

Seth Magaziner, State Treasurer
Rhode Island

James L. McIntire

James McIntire, State Treasurer
Washington

Beth Pearce

Beth Pearce, State Treasurer
Vermont

Ted Wheeler, State Treasurer
Oregon

May 19, 2015

Re: File No. 4-637, Petition to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities

The Honorable Mary Jo White
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman White:

We are writing today representing the undersigned foundations to voice our strong support for the petition before the Securities & Exchange Commission supporting a rulemaking requiring corporate political spending transparency. The rulemaking petition was submitted on August 3, 2011 by the Committee on Disclosure of Corporate Political Spending, a group of prominent law professors specializing in the areas of corporate and securities law. The petition reflects our desire to see the SEC create a Rule requiring such disclosure.

Our foundations invest substantial funds in the market. As investors we believe there is a clear and obvious necessity to require public and accessible information regarding political spending by corporations. We are deeply concerned about how our political system is being negatively impacted by huge inflows of company funds following the Supreme Court's *Citizens United* decision. We are also concerned about the impact on companies in which we invest if they are involved in questionable or controversial political expenditures.

Currently, over 110 major companies already publicly disclose their political spending policies and their direct political payments, including more than half of the S&P 100. These companies include Microsoft, Wells Fargo, Merck and Aetna. Additionally major pension funds such as Calpers and CalSTRS recently adopted policies supporting this type of disclosure.[1]

---

[1] Calpers Political Spending Policies:
http//www.calpers.ca.gov/eip-docs/about/board-cal-agenda/agendas/invest/201111/item03b.pdf

These are important precedents, but we need this type of disclosure across the board, and so we urge the Securities and Exchange Commission (SEC) to promulgate rules requiring public disclosure of corporate spending in elections. Such disclosure should include spending on independent expenditures, electioneering communications, and donations to outside groups for political purposes, i.e. super-PACs and politically active trade associations.

As you know, the *Citizens United* decision changed the face of electoral campaign finance by authorizing, for the first time, unlimited political spending by corporations, which the Supreme Court understands to fall under the definition of "person." While the FEC undoubtedly has jurisdiction over election matters, the SEC has the authority to promulgate rules regarding the procedures through which publicly held corporations spend corporate funds (shareholders' money) for political purposes, as well as disclosure of that spending as material information to shareholders.

We urge the SEC to take up this rulemaking and to hold roundtable discussions with experts on the topic of corporate political spending disclosure. The *Citizens United* decision heavily impacted the 2012 election cycle through the preponderance of entities such as so-called super-PACs, many of which do not disclose funding. Shareholders and the American public have a compelling interest in knowing how corporate funds are being spent in the electoral process.

We urge you to take steps to ensure proper public disclosure of corporate political spending.

Sincerely,

Vartan Gregorian
President
Carnegie Corporation of New York

Stephen Heintz
President
Rockefeller Brothers Fund

Darren Walker
President
Ford Foundation

Gary Bass
Executive Director
Bauman Foundation

Melissa Beck
Executive Director
Educational Foundation of America

Jay Beckner
President
Joyce Mertz Gilmore Foundation

Jane Brown
President and Executive Director
Robert W. Deutsch Foundation

Stuart Clarke
Executive Director
Town Creek Foundation

Alan Davis
President
The Leonard and Sophie Davis Fund

Vic de Luca
President
Jessie Smith Noyes Foundation

Ellen Dorsey
Executive Director
Wallace Global Fund

Farhad Ebrahimi
President
Chorus Foundation

Michael V. Finley
President/Treasurer
The Turner Foundation

Stephen A. Foster
President & CEO
Overbrook Foundation

Ellen Friedman
Executive Director
Compton Foundation

Tim Greyhavens
Executive Director
Wilburforce Foundation

Denis Hayes
President
Bullitt Foundation

Lukas Haynes
Executive Director
David Rockefeller Foundation

Phil Henderson
President
Surdna Foundation

Ruth Hennig
Executive Director
John Merck Fund

Maria Jobin-Leeds
Founder and Chairperson
Access Strategies Fund

Ann Krumboltz
Co-Director
Brainerd Foundation

Anna Lefer Kuhn
Executive Director
Arca Foundation

Justin Maxson
Executive Director
Mary Reynolds Babcock Foundation

Allan Oliver
Executive Director
Thornburg Foundation

Adelaide Park Gomer
President of Board of Trustees
Park Foundation

Mike Pratt
President & Executive Director
Scherman Foundation

Joe Sciortino
Executive Director
Schmidt Family Foundation

Ernest Tollerson
Interim President & CEO
Nathan Cummings Foundation

Steve Viederman
Chair, Finance Committee
Christopher Reynolds Foundation

Kevin Walker
President & CEO
Northwest Area Foundation

Lee Wasserman
Director and Secretary
Rockefeller Family Fund

Marcel Arsenault
President and Founder
Arsenault Family Foundation

Tom Bennigson
Director
Tikva Grassroots Empowerment Fund

Alison Carlson
President
Forsythia Foundation

Andre Carothers
Trustee
Further Foundation

Cynda Collins Arsenault
President
Secure World Foundation

Ann Cornell
President
Cornell Douglas Foundation

Andrew Currie
Founder
Andrew Currie Fund

Jennie Curtis
Executive Director
The Garfield Foundation

R. John Dawes
Executive Director
Foundation for Pennsylvania Watersheds

Nancy V. Deren
Trustee
Lydia B Stokes Foundation

Marion Edey
Philanthropist
Threshold Foundation

Carolyn Fine Friedman
Chair
The Fine Fund

Meg Gage
President
Proteus Fund

Kathryn Gilje
Executive Director
Ceres Trust

Richard Graves
Chair
OPEN Foundation

Jerry Greenfield
President
Ben & Jerry's Foundation

Tom Haas
President & CEO
Thomas W. Haas Foundation

Donna Hall
President & CEO
Women Donors Network

Erik Hanisch
President
Quixote Foundation

Marion Hunt
Philanthropist
Threshold Foundation

Karla James
Managing Director
Rose Foundation for Communities and the Environment

Michael Lerner
President
Jenifer Altman Foundation

Laura Livoti
CEO
Common Counsel Foundation

Pamela Mang
Trustee
Jessica's Love Foundation

Bob Mang
Trustee
Jessica's Love Foundation

Philip McManus
Board Member
Appleton Foundation

Stephen Nichols
President & Founder
Chino Cienega Foundation

Elaine Nonneman
Trustee
Channel Foundation

Hon. Richard L. Ottinger
Trustee
Ottinger Foundation

Doug Phelps
President
Douglas H. Phelps Foundation

Lisa Renstrom
Director
Bonwood Social Investments

Jenny Russell
Executive Director
Merck Family Fund

Frank Sanchez
Executive Director
Needmor Fund

Jonathan A. Scott
President
Singing Field Foundation

Janna Six
Executive Director
Prentice Family Foundation

Daniel Solomon
President
Woodbury Fund

Mark Spalding
President
Ocean Foundation

Mary Ann Stein
President
Moriah Fund

Peter Sullivan
Chair
Clear Light Ventures Fund

John Swift
President
Swift Foundation

Betsy Taylor
Executive Director
Janelia Foundation

Donna Vogel
Executive Director
Chamiza Foundation

Geoff Webb
President
Foundation West

M. Patricia West
Co-Director
West Family Foundation

Lissa Widoff
Executive Director
Robert and Patricia Switzer Foundation

Mary Willis
Executive Director
Morris Family Foundation

Shelley Zimbalist
Managing Director
Solidago Foundation

SEC Should Protect Investors by Requiring Public Companies to Disclose Political Spending

April 21, 2015

Ms. Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
By SEC Web Comment Form

Re: Disclosure Effectiveness Review—Disclosure of Corporate Political Expenditures to Shareholders

Dear Ms. Murphy,

We urge the SEC to issue rules requiring the disclosure of political expenditures by publicly held companies. We are 144 business leaders, entrepreneurs, investors, and philanthropists. Some of us are investment professionals. We hold billions of dollars in investments. Consequently, we have interests in having the companies in which we invest avoid potentially unproductive and risky political expenditures. Securities and Exchange Commission action requiring disclosure of such expenditures is necessary to provide the comprehensive information we need to act as responsible owners.

The absence of disclosure of corporate political spending prevents shareholders and investors from assessing corporate legal, reputational, operational, and other risks. As a result:

- Shareholders cannot properly exercise their ownership rights of corporate oversight;
- Investors cannot make informed investment decisions;
- Shareholders cannot monitor whether such spending may be at odds with the best interests of the corporation or other wider economic concerns; and
- Shareholders cannot determine whether corporate political expenditures are supporting individuals or groups that engage in advocacy on other issues to which they object, and therefore cannot exercise their ownership rights by attempting to restrict such spending or by selling their stakes in the company.

Disclosure of corporate political spending is necessary so that shareholders can evaluate whether a corporation's assets are being utilized in the best interests of the corporation. For example, a corporation may contribute to an organization advocating for corporate tax reform, but that organization may also advocate on a number of other issues that would adversely affect the corporation, such as opposing legislation to deal with climate change that could pose a long-term threat to the corporation's facilities. The Supreme Court in its *Citizens United* decision expressly endorsed the concept of prompt corporate disclosure to allow shareholders to "determine whether their corporation's political speech advances the corporation's interest in making profits."[i]

Moreover, corporations may contribute to organizations that support positions or support candidates who take positions contrary to some shareholders' interests or beliefs in a variety of social, economic, and environmental issues. If shareholders are to avoid subsidizing speech they do not support, they need corporate disclosure of political expenditures to be able to take measures to stop or restrict expenditures they may find objectionable and, if necessary, disassociate themselves from such expenditures by selling their shares. As the Supreme Court wrote this year, "except perhaps in the rarest of circumstances, no person in this country may be compelled to subsidize speech by a third party that he or she does not wish to support."[ii]

Disclosure of political expenditures would also give shareholders a means of averting contributions that may damage the corporation's reputation. The risk and the difficulty in evaluating that risk is compounded when the corporation contributes to third parties such as trade associations or politically active 501(c)(4) groups. Target encountered precisely this problem in 2010 when some consumers boycotted its stores after discovering that the company had made a contribution to an organization which supported a gubernatorial candidate who opposed same-sex marriage and other gay rights measures. The matter resulted in considerable news coverage and a public apology from the company.[iii]

And there seems to be no compelling reason why corporations should not disclose their political expenditures. Keeping track of such spending involves minimal outlays for recordkeeping and publication. Merck, which set up a committee to oversee political contributions after consultation with shareholders, apparently developed reporting measures that were quite manageable. Merck's vice president of state government affairs and policy stated: "The administrative burden wasn't much of a problem."[iv]

Shareholder interest in this issue is more than sufficient to justify SEC action. Prior SEC rules have been crafted to require reasonable disclosure of information for any significant number of interested investors, not just at the request of a majority of shareholders. Over the past three years, the 221 shareholder proxy proposals concerning political and lobbying expenditures earned an average of 24.5% support; two proxy proposals adopted with over 50% vote totals in 2013.[v] This level of support is substantially higher than the 11.2% proxy voting support for executive pay proposals cited by the SEC when it expanded those rules in 1992.[vi] It is worth noting that the proxy vote totals may underestimate the number of investors supporting disclosure since management and executives often own large numbers of shares and typically vote against such proposals.

The Commission has the responsibility to protect investors, and disclosure is essential to that protection. Investors must have access to corporate political spending information if they are to make informed decisions, evaluate risks, monitor the effectiveness of the businesses they own as shareholders, take appropriate action when such spending conflicts with their own beliefs, and avoid reputational harm to the company. As the SEC's website points out, "all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it."[vii]

Shareholders and investors will continue to bear unknown risks until the Commission enacts robust rules on disclosure of corporate political spending. We urge the Commission to promulgate such rules as soon as practicable. We are happy to provide additional information on any of the points raised in this letter. If you need any further information, Daniel Simon, [redacted], will be happy to assist the Commission.

Sincerely,

Brian Arbogast Seattle, WA	Nancy Bagley Washington, D.C.	Anne Bartley San Francisco, CA
Cynda Arsenault Superior, CO	Kathleen Barry Berkeley, CA	Marc Baum New York, NY

Lawrence Benenson
New York, NY

Georgia Berner
Zelienople, PA

Larry Birenbaum
Saratoga, CA

Loren Blackford
New York, NY

Leonore Blitz
Washington, DC

Jabe Blumenthal
Seattle, WA

Robert Bowditch
Brookline, MA

Louise Bowditch
Brookline, MA

Brady Brim-DeForest
Santa Monica, CA

Cassie Carroll
Seattle, WA

Yue Chen
New York, NY

Marilyn Clements
Stamford, CT

John Clements
Stamford, CT

Ben Cohen
Williston, VT

Michael Connolly
New York, NY

Anthony Crabb
Healdsburg, CA

Roy Crawford
Whitesburg, KY

Harriett Crosby
Cabin John, MD

Alan Davis
San Francisco, CA

Patrick deFreitas
Salt Lake City, Utah

Ariane de Vienne
New York, NY

Pouria Dehgan
New York, NY

David desJardins
Burlingame, CA

Cynthia DiBartolo
New York, NY

Shirley Dinkins
Pleasanton, CA

Amy Domini
Cambridge, MA

William Donaldson
Pittsford, NY

Mitchell Draizin
New York, NY

Douglas Edwards
Los Altos, CA

Antonio Elmaleh
Ringoes, NJ

Lauren Embrey
Dallas, TX

Andrew Faulk
San Francisco, CA

Mark Ferron
Mill Valley, CA

Jerry Fiddler
Berkeley, CA

Christopher Findlater
Miami Beach, FL

John Fullerton
Greenwich, CT

Margaret Gamble Boyer
San Francisco, CA

Ron Garret
La Canada, CA

David Goldschmidt
Oakland, CA

James Gollin
Santa Fe, NM

Barbara Grasseschi
Healdsburg, CA

Anthony Grassi
Camden, ME

Richard Graves
Washington, DC

Paul & Eileen Growald
Shelburne, VT

Garrett Gruener
Berkeley, CA

Richard Gunther
Los Angeles, CA

Jeffrey Gural
New York, NY

Diana Hadley
Tuscon, AZ

Nick Hanauer
Seattle, WA

John Harrington
San Rafael, CA

Paul Harstad
Boulder, CO

Lawrences Hess
San Diego, CA

Anne Hess
New York, NY

Suzanne Hess
San Diego, CA

Barbarina Heyerdahl
Montpelier, VT

Arnold Hiatt
Boston, MA

Daniel Hildreth
Portland, ME

Leo Hindery
New York, NY

Joan Huffer
Alexandria, VA

William Janeway
New York, NY

Frank Jernigan
San Francisco, CA

Melissa Johnsen
Saint Louis, MO

Joseph Kaempfer
McLean, VA

Albert Kaneb
Newton, MA

Joel Kanter
Vienna, VA

Craig Kaplan
New York, NY

Woody Kaplan
Boston, MA

Norman Kaplan
Dallas, TX

Barry Karas
Washington, DC

Michael Kieschnick
San Francisco, CA

Ethel Klein
New York, NY

Betsy Krieger
Baltimore, MD

Dal LaMagna
East Norwich, NY

Ruth Lipsomb
Bellevuc, WA

Anna Lyles
Princeton, NJ

Neal MacMillan
Brookline, MA

Richard Mader
Glendale, CA

Hal Malchow
Arlington, VA

Win McCormick
Portland, OR

Terence Meehan
New York, NY

Dennis Mehiel
White Plains, NY

Roger Milliken
Cumberland, ME

Rachel Moore
Ashfield, MA

Lawrence Ottinger
Chevy Chase, MD

Jo Ousterhout
Washington, DC

Yolanda Parker
Los Angeles, CA

Frank Patitucci
Pleasanton, CA

Judy Patrick
Oakland, CA

Morris Pearl
New York, NY

Zach Polett
Little Rock, AR

Stephen Prince
New York, NY

Wade Randlett
San Francisco, CA

Catherine Raphael
Pittsburgh, PA

Lisa Renstrom
Washington, DC

Charles Rodgers
Boston, MA

Abigail Rome
Silver Spring, MD

Marsha Rosenbaum
San Francisco, CA

Steve Roth
Seattle, WA

Fred Rotondaro
Shady Side, MD

Carlynn Rudd
Washington, DC

Vin Ryan
Boston, MA

William Samuels
New York, NY

Keike Schmitz
Palo Alto, CA

John Schram
San Francisco, CA

Benjamin Schwartz
West Springfield, MA

Claire Silberman
Brooklyn, NY

Ian Simmons
Cambridge, MA

Daniel Simon
New York, NY

Adam Simon
Concord, MA

James Simon
New York, NY

Ryan Smith
Salt Lake City, UT

Daniel Solomon
Bethesda, MD

Cathy Steck
New York, NY

Nancy Stephens
Los Angeles, CA

Faye Straus
Lafayette, CA

Patricia Stryker
Fort Collins, CO

Ritchie Tabachnick
Pittsburgh, PA

Valerie Tarico
Seattle, WA

Michael Thornton
Boston, MA

William Titelman
Washington, DC

Carol Tolan
New York, NY

Katherine Villers
Concord, MA

Philippe Villers
Concord, MA

Kathy Washienko
Seattle, WA

Daniel Weise
Kirkland, WA

Millicent Patricia West
Philadelphia, PA

Kelly Williams
New York, NY

Carol Winograd
Stanford, CA

Terry Winograd
Stanford, CA

Joseph Zimlich
Fort Collins, CO

Paul Zygielbaum
Santa Rosa, CA

---

[i] Citizens United v. Federal Election Commission, 130 S. Ct. 867 (2010)

[ii] Harris v. Quinn, No. 11-681, slip op. at 39 (S. Ct. June 30, 2014) <http://www.supremecourt.gov/opinions/13pdf/11-681_j426.pdf>.

[iii] Wing, Nick. "Target Apologizes For Political Donation To Group Supporting Anti-Gay Candidate." The Huffington Post. Huffington Post, 5 Aug. 2010. Web. 14 July 2014. <http://www.huffingtonpost.com/2010/08/05/target-apologizes-for-pol_n_672167.html>.

[iv] Rummell, Nicholas. "Political Disclosures: Reaching The Tipping Point." Corporate Secretary. Corporate Secretary, Cross Border, Ltd., 10 Oct. 2013. Web. 14 July 2014. <http://www.corporatesecretary.com/articles/proxy-voting-shareholder-actions/12556/political-disclosures-reaching-tipping-point/>.

[v] Sustainable Investments Institute. 2013 Season Poised To Break Records In Filings, Support Levels For Environmental And Social Policy Shareholder Resolutions. 20 Aug. 2013. Web. 14 July 2014.

[vi] Bebchuk, Lucian, and Robert J. Jackson, Jr. "Responding to Objections to Shining Light on Corporate Political Spending (5): The Claim That Shareholder Proposals Requesting Disclosure Do Not Receive Majority Support." Blog Post. Harvard Law School Forum on Corporate Governance and Financial Regulation. N.p., 29 Apr. 2013. Web. 14 July 2014. <http://blogs.law.harvard.edu/corpgov/2013/04/29/responding-to-objections-to-shining-light-on-corporate-political-spending-5-the-claim-that-shareholder-proposals-requesting-disclosure-do-not-receive-majority-support/>

[vii] United States Securities and Exchange Commission. "The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation." SEC.gov. Web. 14 July 2014.

April 27th, 2015

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Re: Disclosure Effectiveness Review

Chair Mary Jo White:

We, the undersigned, many of whom are members of the Corporate Reform Coalition, write today in support of petition 4-637 ("to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities").

The Corporate Reform Coalition is a group of more than 80 organizations including investors, corporate governance experts, civil society organizations, and more. As a group we are focused on the evolving need of investors to more fully understand the political activities (and the risks those activities present) of companies in which they invest. It is through that lens that we offer our perspective on the need for enhanced disclosure.

Petition 4-637 was submitted on August 3, 2011 by a committee of prominent law professors seeking to address the issue of corporate political spending transparency, an issue of concern for many investors.

The petition has since received a record-breaking 1.2 million supportive comments, illustrating the extensive concern from investors regarding political expenditures made by public companies with corporate assets without disclosure to shareholders.

The resources of the Securities and Exchange Commission (SEC) are required to write numerous rules, police the markets, and react to changes in company structure. In order to enact its mandate to protect investors the SEC needs to require material disclosures of critical business information for investors, and this includes being able to react quickly to the changing practices and priorities of corporate entities.

One such change was brought about by the 2010 Supreme Court decision *Citizens United.* The decision allowed corporations greater freedom to spend shareholder money to influence politics, however there have still been no new rules or procedures established to ensure that shareholders – those who actually own the wealth of corporations – are informed of decisions about spending their money on politics.

This lack of regulation is in direct conflict with the Court's opinion in the case. In fact, Justice Anthony Kennedy justified permitting corporate electioneering in large part on the expectation that the corporate funders of the ads would be disclosed, thereby enabling shareholders and the public to hold corporations accountable:

"A campaign finance system that pairs corporate independent expenditures with effective disclosure has not existed before today. With the advent of the Internet, prompt disclosure of

expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions.... Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits, and citizens can see whether elected officials are in the pocket of so-called moneyed interests." –Justice Kennedy

The growing number of shareholder resolutions demanding greater investor oversight of corporate political spending further demonstrates the vast shareholder support for such transparency. Shareholders have been concerned about the business sense of corporate political spending for some time – but the concerns have become more pronounced as the scope and nature of corporate political activity has expanded under *Citizens United*. Since 2010, shareholders have filed 530 resolutions on corporate political activity, making it by far the most common shareholder proposal, including 110 resolutions in 2014.

These figures demonstrate clear and ongoing demand from investors for this information. We infer from the voting results, and the negotiated policy changes, strong agreement with the observation made in the initial rulemaking petition filed by 10 prominent securities law professors: "Absent disclosure, shareholders are unable to hold directors and executives accountable when they spend corporate funds on politics in a way that departs from shareholder interests."

Without adequate disclosure of corporate political spending, shareholders and investors have little means to hold corporate directors accountable and to safeguard their investments. And investors understand this; a recent survey of members of the CFA Institute, an association of professional investors, found that 60% of members believe that if corporations are able to spend money in elections, they should be required to disclose the spending.

However because there are no current rules that require that companies disclose this spending to their shareholders, it is essentially impossible for an investor to obtain a full picture of any individual company's political spending unless the company chooses to disclose. Without an SEC rule requiring full disclosure for all public companies, shareholders have no uniform means to monitor these activities, or assess the risks of corporate political spending. Voluntary disclosure has led to a patchwork of understanding which makes it impossible for investors to manage, and potentially mitigate, the full range of risks presented by corporate political spending.

From an issuer's perspective, a disclosure mandate would level the playing field by relieving concern that disclosing activities could disadvantage the issuer's standing or competitiveness.

The robust support for petition 4-637 and the general concerns of those in the investment world must not be ignored by the agency tasked with protecting their interests. Shareholders should not be left in the dark when their companies spend their money to influence a political cause. Information on political spending is material to shareholders as they make decisions about where to invest, particularly with growing evidence that political spending might not always benefit the corporate bottom line.

Sincerely,

Agenda Project Action Fund

American Federation of Labor and Congress of Industrial Organizations (AFL–CIO)

American Federation of State, County and Municipal Employees (AFSCME)

Alliance for a Just Society

Avaaz

Boston Common Asset Management

Brennan Center for Justice at NYU School of Law

California Clean Money Campaign

Center for Biological Diversity

Center for Community Change

Center for Effective Government

Center for Science and Democracy at the Union of Concerned Scientists

Citizen Works

Citizens for Responsibility and Ethics in Washington

Clean Yield Asset Management

Congregation of Sisters of St. Agnes

Congregation of St. Joseph

Communications Workers of America (CWA)

Common Cause

Demos

Democracy 21

Dominican Sisters of Hope, Ursuline Sisters of Tildonk, U.S. Province

Every Voice

Harrington Investments, Inc

Government Accountability Project

Greenpeace US

Institute for Agriculture and Trade Policy

Investor Voice, SPC

Issue One

Interfaith Center on Corporate Responsibility

Main Street Alliance

Mercy Investment Services

Nell Minnow, founder of Governance Metrics Institute

New Economy Project

New Progressive Alliance

Newground Social Investment, SPC

Northwest Coalition for Responsible Investments

NorthStar Asset Management, Inc.

OIP Trust and Missionary Oblates USP

Pax World Management

People for the American Way

Public Campaign

Public Citizen

Social Equity Group

Sonen Capital, LLC

Stamp Stampede

Sunlight Foundation

Susan Makos; Daughters of Charity, Province of St. Louise

International Brotherhood of Teamsters (IBT)

Trillium Asset Management, LLC

U.S. Public Interest Research Group (U.S. PIRG)

ValueEdge Advisors

Walden Asset Management

West Virginia Citizen Action Group

Wisconsin Democracy Campaign

Voices for Progress

Zevin Asset Management, LLC

COALITION FOR SENSIBLE SAFEGUARDS

The Independent Agency Regulatory Analysis Act

Politicizing Independent Agencies and Putting Americans in Harm's Way

The Independent Agency Regulatory Analysis Act would fundamentally change the way that independent agencies operate. Examples of independent agencies include, among others, the Consumer Financial Protection Bureau, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Consumer Product Safety Commission, the Nuclear Regulatory Commission, and the National Labor Relations Board. The Independent Agency Regulatory Analysis Act would strip these agencies of much of their independence, requiring them to spend limited resources completing detailed cost-benefit analyses – even when Congress has not required this – and then to submit their analyses for review by the Office of Information and Regulatory Affairs (OIRA).

Congress should not cede control of independent regulatory agencies to the president. Unlike executive agencies, independent agencies are accountable to Congress and not under the control of the president. Where executive agency heads serve at the pleasure of the president, independent agency heads have a defined tenure that is independent of the election cycle. Congress frequently chooses to establish independent agencies when, in its judgment, the policy area affected needs to be insulated from the political pressures associated with being part of the executive branch.

In many cases, independent regulatory agencies' independence has allowed them to respond nimbly to emerging crises. For example, on Aug. 15, 2012, the Consumer Product Safety Commission recalled 4 million Bumbo Baby Seats in response to evidence that babies had been injured while sitting in them. This is a stark contrast with executive agencies, which often need years to respond to hazards. For example, the CEO of S.C. Johnson said of the Environmental Protection Agency's ability to regulate even known carcinogens under the Toxic Substances Control Act, "Your child has a better chance of becoming a major league baseball player than a chemical has of being regulated."1

Independent regulatory agencies' ability to protect people's lives and well-being would be undercut by a cost-benefit analysis supermandate. Independent regulatory agencies are quite different from one another – in structure, in statutory authority, and in the requirements they must meet to regulate. Overriding Congress' direction to each agency and requiring instead a preeminent focus on economic impact is, simply put, bad policy. This is because cost-benefit analysis fails when benefits and costs cannot be properly quantified.

Any requirement for cost-benefit analysis across all independent regulatory agencies would limit their ability to protect Americans from nuclear meltdowns, keep lead paint off children's toys, and stand guard against another mortgage fiasco. For example, the Federal Aviation Administration (FAA) is an executive agency that works to protect the flying public. Since it has been so successful doing so, there have been relatively few plane accidents over the past decade. That very success has made it more difficult for the agency to keep its rules current because under the blanket cost-benefit analysis requirement, there has not been enough loss of life to justify safety improvements.2

The bottom line: The Independent Agency Regulatory Analysis Act would politicize independent regulatory agencies and make it harder for them to protect Americans.

www.SensibleSafeguards.org

COALITION FOR SENSIBLE SAFEGUARDS

The Independent Agency Regulatory Analysis Act

The following examples suggest ways that the Independent Regulatory Analysis Act would hamper independent agencies' ability to protect Americans from death, injury, illness, and other harm:

Consumer Financial Protection Bureau: The Consumer Financial Protection Bureau (CFPB) was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to protect the financial security of American families from a wide range of predatory and deceptive lending practices. The CFPB is already required to subject its rules to a cost-benefit analysis, as well as an unprecedented set of checks on its authority. For example, the CFPB must proactively consult with federal banking agencies and other agencies to ensure that its proposals are not in conflict with those other agencies' rules, and the Financial Stability Oversight Council may stay or set aside CFPB standards. Subjecting CFBP's rulemakings to additional review by the Office of Information and Regulatory Affairs and to redundant cost-benefit analysis requirements will do nothing to improve its rules and will only add delay and uncertainty to the rulemaking process.

Securities and Exchange Commission: Last year, the Securities and Exchange Commission (SEC) saw one of its rulemakings thrown out after a federal court found that the agency's cost-benefit analysis was not sufficiently robust. The rule at issue – the "proxy access rule" – was part of Dodd-Frank and was designed to give shareholders more opportunity to influence the governance of public companies. The SEC conducted a cost-benefit analysis as directed by the statute, yet the court found that the analysis was inadequate. The enhanced cost-benefit analysis requirements and judicial review provisions of the Independent Regulatory Analysis Act could similarly imperil other SEC rules, as well as those at other independent agencies.

Consumer Product Safety Commission: The Consumer Product Safety Commission (CPSC) was created after Congress found that litigation, industry self-regulation, and the existing system of federal, state, and local laws were inadequate to protect Americans from unreasonably dangerous products. In 2008, the Consumer Product Safety Improvement Act (CPSIA) empowered the agency to require that infant and children's products be safety-tested before being sold, to ban lead and phthalates in children's products, and to create the first publicly accessible, searchable database of consumer complaints. The agency oversees more than 15,000 different types of consumer products and, in addition to CPSIA, administers a range of laws that have been wildly successful in protecting Americans from death, injury, and illness. The agency has its own economic analysis requirements based on what type of product is being regulated and what type of risk is being addressed – recognizing, for example, the importance of ensuring that car seats and cribs are as safe as possible. Among its other regulatory efforts, the agency is currently working to ensure that safety tests and testing facilities are holding children's products to the appropriate standard under the law. Delaying these protections with a supplemental and inconsistent cost-benefit analysis supermandate could mean that American children would lack the protection Congress has provided.

Nuclear Regulatory Commission: The Nuclear Regulatory Commission (NRC) regulates nuclear reactors, nuclear materials, nuclear security, and radioactive waste. The agency's long-standing practice is that standards necessary for the "adequate protection" of the public do not require economic justification. Yet, when the agency realized in the wake of Japan's 2011 Fukushima Daiichi disaster that America's nuclear power plants were not adequately safeguarded and recommended a set of upgrades, the nuclear industry responded by citing the high cost of repairs and demanding a cost-benefit analysis of the changes. As a result, no changes have been made to date, and Americans are still not adequately protected from risks the agency has acknowledged to exist. Layering on a statutory requirement for cost-benefit analysis could further delay not only these critical changes, but would result in all of NRC's future regulatory efforts being evaluated on their economic, rather than their public safety, impact.

AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY • FAIRNESS • SECURITY

Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

The Honorable Mel Watt
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

The Honorable Debbie Matz
Chair
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: RIN 3064-AD56, Incentive-Based Compensation Arrangements

Dear Officers,

We write to urge you to impose strong regulatory restrictions on Wall Street executive pay and bonuses to ensure that they do not create incentives to take inappropriate short-term risks. Section 956 of the Dodd-Frank Act contains a statutory mandate for you to take action in this area. However, this law has not been implemented, and the proposal for implementation made three years ago, in 2011, is inadequate to the problem and would not significantly shift pay practices on Wall Street.

Ensuring appropriate pay incentives at financial institutions should be a critical priority. By permitting executives and traders to 'take the money and run' excessive short term bonuses encouraged practices that earned money in the short run but blew up later, leaving taxpayers with the bill. One Harvard study estimates that top executives of Bear Stearns and Lehman took out over $2.5 billion from the companies in the years prior to their failure, and never had to repay a dime of it.[1]

Many observers have emphasized the role of pay in creating the incentives that led to the 2008 financial crisis. The Senate Permanent Subcommittee on Investigations found that pay incentives throughout the firm played a major role in inducing Washington Mutual to make inappropriately high-risk loans, eventually driving the firm into bankruptcy.[2] The Financial Crisis Inquiry Commission found that pay systems too often encouraged "big bets" and rewarded short-term gains without proper consideration of long-term consequences.[3] Perhaps most telling of all, multiple surveys have found that over 80 percent of financial market participants believe that compensation practices played a role in promoting the excessive risk accumulation that led to the financial crisis.[4]

Section 956(b) of the Dodd-Frank Act is a direct response to this concern. Section 956(b) mandates that you prohibit "any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks". The near-universal consensus on the centrality and importance of compensation incentives to the behavior of financial institutions makes it all the more disappointing that Section 956 has not been implemented and that its proposed implementation is so inadequate.

Americans for Financial Reform and many of our member organizations submitted letters in response to the agencies' request for comment in the spring of 2011 that detail key weaknesses in the 2011 proposed rule.[5] In this letter, we detail our critique of the proposed rule and outline our key recommended changes. We urge you to take action on this long overdue mandate and to significantly strengthen your 2011 proposed rule by incorporating the recommendations discussed below.

The 2011 proposed rule mostly relied on conceptual and generalized instructions to boards of directors, and essentially reiterated broad statements of principle already included in the regulators "Interagency Guidance on Sound Incentive Compensation Policies". It is true that these broad principles were supplemented with some specific requirements concerning incentive pay structures. However, the specific requirements -- a 50 percent deferral of incentive pay for up to three years -- are weak, and would not substantially change existing Wall Street practices. In fact, these requirements would seem to permit many of the pay practices that existed at poorly managed institutions even prior to the financial crisis.

---

1 Bebchuk, Lucian A. and Cohen, Alma and Spamann, Holger, "The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008" ; Yale Journal on Regulation, Vol. 27, 2010, pp. 257-282; Harvard Law and Economics Discussion Paper No. 657; ECGI - Finance Working Paper No. 287.

2 United States Senate, Permanent Subcommittee on Investigations, "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse", April 13, 2011.

3 Financial Crisis Inquiry Commission, "Financial Crisis Inquiry Report", February 25, 2011.

4 Financial Stability Forum, "FSF Principles for Sound Compensation Practices", April 2, 2009. See page 4, footnote 2, for a review of these surveys.

5 AFL-CIO, "Comment on Incentive Based Compensation Arrangements", May 31, 2011. Americans for Financial Reform, "Comment on Incentive Based Compensation Arrangements", May 31, 2011. Public Citizen, Congress Watch, "Comment on Incentive Based Compensation Arrangements". May 31, 2011.

Making Section 956 effective requires much stronger and more far reaching specific requirements for the deferral of bonus pay, a prohibition on executive hedging, and restrictions on risk-inducing pay structures practices such as stock options. As you move forward on implementing this rule, we urge you to make the following changes to the proposed rule:

- An adequate rule must address the form of pay, not simply its deferral. The use of equity-based compensation at banks should be restricted in order to align employee interests with the safety of the bank and the interests of the public.
- An adequate rule must require longer and more meaningful deferral, to ensure that incentive pay is not based on activity that has proven unsound over time.
- An adequate rule must ban hedging of incentive pay awards. The ability to hedge incentive pay effectively undoes the positive incentive effects created by pay deferral.
- The specific incentive pay requirements in the final rule must apply to a wider population of employees, not simply a few top executive officers.

In addition to these basic changes, we also recommend that you devote additional consideration to the application of these rules to important investment advisory entities, including those that may not reach the threshold of a $50 billion balance sheet. Investment advisors are explicitly included in the Section 956 statutory mandate, and there would be public benefit from thoughtfully designed requirements to align incentive pay with long-term wealth creation at these companies. While the proposed rule does cover a number of the largest asset managers, the potential of the rule for addressing issues in asset management is not fully realized, as both the business model and regulatory oversight of investment advisors differs from banks in important ways that are not reflected in the proposed rule.

In the remainder of this letter, we discuss the March 2011 proposed rule and the nature and justification of our recommendations for improvement in greater detail. Should you wish to discuss these recommendations further, please contact Marcus Stanley, AFR's Policy Director, at 202-466-3672 or marcus@ourfinancialsecurity.org, or Bart Naylor, Public Citizen's Financial Policy Advocate, at bnaylor@citizen.org.

Comments on the March 2011 Proposed Rule

The March 2011 proposed rule limits incentive pay in two ways.[6] First, the rule requires all financial institutions to comply with a set of broad conceptual standards on pay. Incentive pay must "balance risk and reward", which may occur through a variety of methods including "deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or longer performance periods".[7] Other unspecified methods for balancing risk and reward developed by covered financial institutions could also be acceptable to satisfy this requirement.[8] These methods must also be "compatible with effective controls and risk management" and "supported by strong corporate governance". The discussion in the proposed rule indicates that these standards will be enforced through the bank supervisory process.

[6] 12 CFR Part 1232, "Incentive Based Compensation Arrangements", Federal Register Vol. 76 No. 72, April 14, 2011.
[7] See e.g. Proposed Paragraph 236.5(b)(2) under Regulation JJ in the Proposed Rule.
[8] CFR 21179 of Proposed Rule.

As a supplement to these broad conceptual principles, the rule also includes some more specific pay deferral requirements that apply to top executive officers at financial institutions with over $50 billion in consolidated assets. At least 50 percent of incentive pay to such officers must be deferred over a period of three years, with equal pro rata payments permitted over each year of the deferral period. Deferred payments must be adjusted for actual losses that materialize over the deferral period.

This combination is unacceptably weak and does not satisfy the statutory mandate. First, the broad principles-based directives in the rule appear to effectively delegate the determination of specific required restrictions on incentive pay to boards of directors, which have consistently failed to effectively control pay incentives in the past. This self-regulatory approach is unacceptable. The range of practices cited in the rule as satisfying the requirement to 'balance risk and reward' in pay are so broad that they do not significantly restrict incentive pay structures. For example, companies could satisfy these requirements simply by calculating incentive bonus awards using ex ante and hypothetical risk adjustments generated by internal risk models. Similar internal models failed to predict losses prior to the financial crisis. In addition, the delegation of these key decisions to boards of directors does not satisfy the statutory requirement that *regulators* determine which pay arrangements create inappropriate risk.

The excessive reliance on the board of directors to provide effective and detailed direction concerning the broad conceptual principles laid out here is a particular weakness of the rule. The failure of bank corporate governance arrangements, which center on the board of directors, was a major contributor to the financial crisis.[9]

Since the financial crisis supervisors have attempted to strengthen corporate governance and risk management through supervisory action. The proposed rule states that the general principles in the rule will be enforced through the regulators' supervisory interactions with each financial institution. But this approach will result in an opaque and unaccountable process that is highly dependent on particular supervisory relationships. Prior to the financial crisis, prudential agencies already had safety and soundness authorities with respect to bank holding companies that would have permitted supervisors to examine whether incentive pay structures induced excessive short-term risk taking. Yet these authorities were clearly not sufficiently used.

While we welcome the new supervisory focus on corporate governance and pay arrangements, we do not feel that such supervisory action alone constitutes an adequate implementation of the statutory ban on incentive pay that induces excessive short-term risk. The very general principles referenced in the rule, and the wide range of options listed as adequate to satisfy the requirement to 'balance risk and reward' in pay, indicate that key decisions in pay structure will not be significantly constrained by supervisory enforcement of these principles. The lack of clear and specific guidance in the rule will make it difficult for supervisors to be effective in requiring meaningful change. Furthermore, current supervisory efforts to improve pay practices indicate

---

[9] Kirkpatrick, Grant, "Corporate Governance Lessons From the Financial Crisis", OECD Financial Market Trends, 2009.

that such efforts rely heavily on ex-ante risk adjustments using hypothetical models, as well as internal processes heavily dependent on judgments by the board of directors.[10]

The second part of the Proposed Rule, which places concrete and specific restrictions on incentive pay structures at financial institutions with over $50 billion in assets, could have done much to address the vague and conceptual nature of the other aspects of the Proposed Rule. Unfortunately, these restrictions are inadequate. They would not lead to improvements in current financial sector pay practices, and indeed would not have been strong enough to change pay practices even if they had been enforced prior to the financial crisis.

The proposed restrictions would require that half of incentive pay for top (named) executive officers be deferred over at least a three years period. Pay could be distributed in equal pro rata shares during the period. This standard does not represent meaningful change from the pre-crisis status quo, and is therefore clearly inadequate to make progress in addressing the problem. For Example, as far as we can tell, an incentive pay plan in which half of compensation consisted of an immediate cash bonus and half consisted of stock options that would vest in equal shares over the next three years would satisfy the requirement. These kinds of incentive plans are already common forms of payment in financial institutions, and were also common before the financial crisis.[11] Even institutions like Citigroup and Washington Mutual, whose conduct was a clear example of destructive short-term thinking, had stock award programs that would seem to satisfy the deferred compensation requirement under the proposed rule.[12]

To be effective in reforming financial sector pay practices, a final rule should incorporate the following four changes:

1) Restrictions on the use of equity-based compensation.
2) Longer and more stringent requirements for pay deferral.
3) A ban on executive hedging of incentive pay.
4) Application of the incentive pay requirements to a wider population of employees.

If these four changes were made, the rule would significantly alter pay incentives at major financial institutions, which the current proposal does not do. At the same time, these four changes would still allow institutions substantial flexibility in the level and structure of pay.

We also recommend a stronger application of these rules to non-bank asset managers than exists in the current rule.

These recommendations are discussed in more detail below.

---

[10] For example, the Federal Reserve's review of compensation processes identifies the modeling of stressed add-ons for liquidity risk to incentive compensation awards as a 'leading-edge practice'. Federal Reserve, "Incentive Compensation Practices: A Horizontal Review of Practices at Large Banking Organizations", Board of Governors of the Federal Reserve System, October, 2011.

[11] See for example, page 200 of Citigroup's 2006 Form 10-K describing pay arrangements, available at http://www.citigroup.com/citi/fin/data/k07c.pdf.

[12] See for example pp. 93-94 of Washington Mutual's 2007 Form 10-K, available at www.sec.gov/Archives/edgar/data/933136/000104746908006870/a2185889z10-ka.htm .

1) Restrictions on equity-based compensation

The Proposed Rule does not address the form of incentive pay. It is common practice to pay bonuses at the typical company in stock so as to align the interests of equity owners and managers. Stock-based compensation gives asymmetric incentives, with substantial benefits for increases in stock price but without commensurate losses associated with poor performance or failure. For example, a stock option increases executive wealth dollar for dollar with increases above the exercise price, but losses below the exercise price have no wealth effect. This structure creates a fundamental misalignment between the incentives created by equity-based pay and the interests of those fully exposed to the downside risks of company failure, such as creditors and taxpayers.

It is well known that the interests of equity holders differ from those of creditors. This conflict may be particularly intense at financial institutions because they are highly leveraged. Bank equity is often a small percentage—less than 6%--of total bank funding. After interest payments, the class that only provides 6 percent of funding owns 100 percent of the profits as well. Yet the equity holders have strikingly different incentives from bank creditors. Particularly if there is any chance of debt default, which would wipe out equity holders while allowing more senior creditors at least partial recovery, the interests of equity holders as the most junior claimants is to 'gamble for resurrection' of the bank by taking excessive risks. If the risks pay off, equity holders will enjoy the upside and any additional losses created will fall on more senior creditors A related issue is the problem of 'debt overhang', or the disincentive for equity holders to raise additional capital when the firm is in distress, as such capital would dilute their equity stake while benefiting more senior creditors.

These incentive conflicts are also exacerbated at banks by the possibility of taxpayer funding of bank losses. Deposits are taxpayer-insured. This means banks enjoy not only subsidized leverage, but a class of creditors who need not pay attention to the credit worthiness of the bank. The risks that bankers may take with these deposits may benefit shareholders if successful, but can jeopardize taxpayers if not. Similarly, the possibility that government may be forced to back even the non-deposit liabilities of a large bank holding company, as occurred in 2008-2009, creates a situation where taxpayers are exposed to downside risks in the bank. Similarly to other creditors, equity-based payments do not align the interests of bank executives with taxpayers, and in fact create incentives for excessive risk-taking from the perspective of taxpayer's interests.[13]

We believe that a simple means of reducing inappropriate risk taking by bank managers is through the significant restriction or elimination of equity-based compensation, which could be accomplished under section 956. Equity awards could be limited and replaced with deferred cash bonuses, or with payments in company debt that must be held to maturity and are at risk based on bank performance. While the exact incentives created by such non-equity payments will vary depending on their design, they share in common that they create a significantly greater exposure to downside risks than equity-based payments do, thus better aligning executive incentives with the interests of creditors and taxpayers.

---

[13] For a good discussion of all these issues see Squam Lake Group, "Aligning Incentives at Systemically Important Financial Institutions", March 19, 2013.

To serve as an effective form of incentive alignment, any non-equity based payment must remain at risk for a significant deferral period. For example, if payments are given in company bonds, there must be a requirement that such bonds are held to maturity, and there must be a mechanism for reducing or withholding bond payments based on outcomes during the deferral period.

The proposal to reduce or eliminate equity-based incentive pay in favor of deferred cash or debt instruments is hardly a radical one. It has been endorsed by many experts. For example, the Squam Lake Group, which includes over a dozen distinguished economists, has endorsed a payment method based on 'bonus bonds'. Lucian Bebchuk of Harvard Law School has advocated restrictions on equity-based pay and a greater use of payments in bonds.[14] New York Federal Reserve Bank President William Dudley has also stated that requiring senior management deferred compensation to be held in the form of long-term debt would "strengthen the incentives for proactive risk management."[15] Federal Reserve Gov. Daniel Tarullo similarly explored this idea in a June, 2014 speech, noting the appeal of "making incentive compensation packages more closely reflect the composition of the liability side of a banking organization's balance sheet by including returns on debt."[16]

There is also significant academic research demonstrating a link between equity-based compensation incentives, particularly stock options, and bank failure, as well as research drawing a link between non-equity deferred compensation and positive bank performance.[17] Such research also supports restrictions on equity-based pay.

Deferred compensation

As a supplement to the more principles-based directives to boards of directors, the proposed rule provides for a mandatory deferral of at least 50 percent of the annual incentive-based compensation granted to top (named) executive officers over a three year disbursement period. As banking generally involves risks whose results may not become apparent for a number of years, deferral represents an important mechanism for directing executive incentives toward long-term results. As economist Raghuran Rajan has pointed out, true financial returns can only be measured "in the long run and in hindsight", and in the short run financial executives have ample opportunities to disguise long-term risks while earning short-term profits.[18]

That is why an effective proposal needs a more robust deferral requirement. The deferral requirement in the proposed rule is much too limited and much too short. Half of incentive

---

[14] Bebchuk, Lucian A., "How to Fix Bankers' Pay" Daedalus, Vol. 139, No. 4, Fall 2010; Squam Lake Group, "Aligning Incentives at Systemically Important Financial Institutions", March 19, 2013.

[15] Dudley, William, "Global Financial Stability: The Road Ahead", Remarks at Tenth Asia-Pacific High-Level Meeting on Banking Supervision, Auckland, New Zealand, February 26, 2014.

[16] Tarullo, Daniel, "Speech at American Association of Law Schools, June 9, 2014. available at: http://www.federalreserve.gov/newsevents/speech/tarullo20140609a.htm

[17] Bennett, Rosalind L. and Guntay, Levent and Unal, Haluk, "Inside Debt, Bank Default Risk and Performance during the Crisis", February, 2014. FDIC Center for Financial Research Working Paper No. 2012-3 .Kogut, Bruce and Harnal, Hitesh, "The Probability of Default, Excessive Risk, and Executive Compensation: A Study of Financial Services Firms from 1995 to 2008" Columbia Business School Research Paper, February 21, 2010; Bhagat, Sanjai and Bolton, Brian J., "Bank Executive Compensation and Capital Requirements Reform", May 2013;

[18] Rajan, Raghuram, "Bankers Pay is Deeply Flawed," by Raghuram Ragan, Financial Times, January 2008.

compensation can be granted immediately, and the other half may be granted in equal pro rata shares over a three-year period. This implies that almost 85 percent of incentive compensation may be paid within two years of the original grant.[19] As discussed above, pay packages that satisfied this requirement were common even prior to the financial crisis (e.g. stock options that vested over two to three years), and the requirement would not significantly change practices on Wall Street today. We believe that withholding only half of the incentive pay is too little, three years is too short a period for withholding, and the pro rata disbursement is inappropriate.

There can certainly be legitimate disagreement over the exact length of an appropriate deferral period. However, as a general principle, a deferral period should be at least adequate to cover a typical asset price cycle in the financial markets. That is, a decision maker should be aware that their incentive payments will only be forthcoming if the financial institution is able to sustain its returns through the entire run of a business cycle. The deferral period in this proposal clearly does not meet this requirement. For an example, under this proposal, if a bank became heavily involved in subprime mortgage markets in 2003, then top executives would have collected 85 percent of their bonuses by 2005 and the entire bonus by 2006, when pricing issues in the subprime markets first began to appear.

Evidence from past financial cycles should be used to determine a deferral period adequate to properly align incentives, and a *significant majority* of incentive pay should be held at risk over the full period. We would point out that a recent proposal from the Bank of England specifies that incentive pay should remain at risk for clawbacks over a seven year period.[20]

Employees covered

The deferral requirement also falls short in the scope of its application. The requirement would apply only to named executive officers and heads of major business lines. This would likely apply to less than a dozen persons at most large institutions. But there are hundreds if not thousands of individuals at major banks that receive large incentive awards due to their role in risk decisions. A report by then New York Attorney General Andrew Cuomo found that 1,626 employees of JP Morgan received a bonus more than $1 million annually. At Goldman Sachs, 953 employees received more than $1 million in bonuses.[21] Compensation rules for material risk takers in other jurisdictions apply to a far greater number of these employees. For example, the European Banking Authority proposed criteria for remuneration regulation that would apply to those who receive more than EUR 500,000 or fall within the highest 0.3% of pay at the firm.[22] The London Whale episode at JP Morgan stands as a reminder that individual traders can contribute to substantial losses. In this episode a few traders lost more than $6 billion, about 3 percent of the firm's capital.

---

[19] Since half of bonus pay could be paid immediately, and the other half paid in equal pro rata shares over three years, this implies that up to 83 percent (50 percent + 16.3 percent in year 1 and 16.3 percent in year 2) could be paid within two years.

[20] Bank of England, Prudential Regulatory Authority, "Clawback", Policy Statement PS7/14, July, 2014.

[21] Cuomo, Andrew,"No Rhyme or Reason: The Heads I Win Tails You Lose Bank Bonus Culture", Attorney General of the State of New York, 2008.

[22] European Banking Authority, "Regulatory Technical Standards for Material Risk Takers,", December 2013.

The rule does require that the board of directors identify material risk takers beyond the named executive officers to whom the deferral requirement applies. The board of directors is instructed to ensure that these material risk takers have incentive pay packages that are appropriately risk sensitive. However, no specific pay restrictions are required for these designated risk takers, and the actual decisions on incentive compensation structure are left to the board of directors. As discussed above, we do not believe complete reliance on the board of directors is appropriate as a means of regulating financial sector pay incentives.

The agencies should apply specific compensation limitations well beyond the small population of senior managers that was designated in the initial proposed rule. In a 2011 review, the Federal Reserve found that at the large banking organizations, "thousands or tens of thousands of employees have a hand in risk taking." But these banks had failed to identify these employees or adjust their compensation so as to discourage excessive risk-taking.[23] We believe that broad compensation structure requirements involving pay deferral should apply to any material risk-taker.

Hedging

The agencies' proposed rule is silent on the issue of hedging. We believe hedging of compensation should be summarily prohibited as it clearly undermines the intent of the rule. Pay deferral will not be effective as a means of inducing sensitivity to long-term risks if employees can effectively undo the deferral by hedging their future pay. The consensus view of the 13 distinguished economists on the Squam Lake Group phrased the situation well[24]:

> "Of course, holdbacks only reduce management's incentives to take excessive risk if management cannot hedge its deferred compensation. Any hedging of deferred compensation should therefore be prohibited."

Incentive compensation hedging strategies reduce or eliminate the sensitivity of executive pay to firm performance, and thus can directly conflict with Congressional intent to mandate incentive pay structures that discourage inappropriate risks.[25]

Application of Incentive Pay Rules to Non-Banks

The statutory mandate in Section 956 explicitly covers investment advisors. The application of the Proposed Rule to investment advisors tracks its application to banks, with investment advisors holding $1 billion or more of consolidated balance sheet assets subject to the essentially principles-based portion of the rule, and investment advisors with $50 billion or more of consolidated balance sheet assets subject to the more specific deferral requirements. The SEC estimates that 68 registered advisors have $1 billion or more in balance sheet assets, and 7

[23] Federal Reserve, "Incentive Compensation Practices: A Horizontal Review of Practices at Large Banking Organizations", Board of Governors of the Federal Reserve System, October, 2011.
[24] Squam Lake Group, "Aligning Incentives at Systemically Important Financial Institutions", March 19, 2013.
[25] Larcker, David and Brian Tayan, "Pledge (And Hedge) Allegiance to the Company", Stanford Graduate School of Business, Closer Look Series, October 21, 2010.

advisors have $50 billion or more.[26] We believe that the stronger deferral requirements recommended above should apply to these investment advisors as well.

However, we are concerned that the more principles-based portions of the rule may not be effectively enforced at investment advisors, given that there is no prudential supervision of investment advisors. In addition, we are concerned that many investment advisors with large amounts of assets under management, whose actions in the aggregate may have profound impacts on the financial system, may not be subject to the full scope of the rule due to limited assets on their balance sheet. A survey by Price Waterhouse Coopers conducted after the release of the Proposed Rule found that almost no asset managers expected the Proposed Rule to impact their pay practices.[27] This is likely partially due to the general weakness of the Proposed Rule, as discussed above, and the limitations in its applicability to asset managers.

We believe that the application of a stronger rule to a broader range of asset managers could have significant benefits for the stability of the financial system and the protection of investors. First, we believe specific incentive pay requirements oriented toward aligning incentives with long-term returns could address systemic risk concerns raised in regard to asset management practices, and in some cases could do so more effectively than prudential supervision. We believe that such pay restrictions could be an important element in the current effort by the Securities and Exchange Commission to regulate the potential systemic risks created by asset managers, and should be integrated with that effort. Second, properly designed pay requirements could also lessen incentives for abusive practices that impact investors, such as those revealed in SEC examinations of private equity firms.[28] We would urge the SEC and other agencies to reconsider the scope and nature of the incentive pay requirements applicable to asset managers.

Your consideration of these comments is appreciated. As one of the central causes of the financial crisis, inappropriate compensation incentives oblige the regulators to implement strong reforms. While we are dissatisfied that this reform is so long delayed, we encourage the agencies to implement a robust and effective rule and to make sure they get the text right in their next draft through either a revision or a re-proposal. By doing so, they will serve the American public well. For questions, please contact Marcus Stanley, the Policy Director of Americans for Financial Reform, at marcus@ourfinancialsecurity.org or (202) 466-3672; or Bartlett Naylor, Public Citizen's Financial Policy Advocate, at bnaylor@citizen.org.

Sincerely,

Americans for Financial Reform

---

[26] See footnote 40 in the Proposed Rule

[27] Benjamin, Barry and Scott Olson, "2011 US Asset Management Reward and Talent Management Survey Results", PWC Incorporated, March 2012. See page 12 of the document, which states: "While every survey participant was familiar with the proposed compensation requirements under Section 956 of Dodd Frank, only one participant indicated the proposed compensation rules, in their current form, would have a direct impact on their organization's compensation structure."

[28] Bowden, Andrew, "Spreading Sunshine In Private Equity", Speech at Private Equity International, May 6, 2014.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government

- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center

- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA

- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME

- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council

- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET

PUBLIC CITIZEN
215 Pennsylvania Avenue, SE • Washington, D.C. 20003 • 202/546-4996 • www.citizen.org

April 20, 2015

Mary Jo White, Chair
c/o Mr. Brent J. Fields,
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington DC 20549-1090

Re: Disclosure of Hedging by Employees, Officers and Directors

Reference: File Number S7-01-15

Dear Chair White,

On behalf of more than 350,000 members and supporters of Public Citizen, we appreciate the opportunity to comment on the proposed U.S. Securities and Exchange Commission's (SEC or Commission) regulation titled "Disclosure of Hedging by Employees, Officers and Directors" (17 CFR parts 229 and 240).

> In summary, we support the Commission's proposed rule. The text of the Dodd-Frank Wall Street Reform and Consumer Protection Act statute is clear. The proposed rule essentially restates the statute. However, because the rule consists of a restatement of the statute it is difficult to justify the five years that has elapsed since Congress approved the statute mandating this rule. As such, we express frustration with the conspicuous lack of progress in completing this and the other executive compensation and financial reforms required under the Wall Street reform law. The Commission does not have the discretion to ignore congressional directives that some commissioners may oppose.

Overview

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains a number of provisions in Title IX designed to make executive compensation practices transparent to investors. Inappropriate compensation practices figured at the center of the 2008 financial crisis: mortgage originators who were paid by the volume instead of integrity of loans polluted the financial system with toxic assets, mortgage securitizers paid with lucrative fees ignored these dangers as they sold these assets to outside investors, traders received rich rewards for fatal risk-taking, and senior bankers-- even those whose firms subsequently failed such as Bear Stearns and Lehman Brothers-- nevertheless pocketed tens of millions of dollars in compensation.[1] Numerous pathologies of the crisis attest to the central role of bad compensation policies.[2]

To help address this, the Dodd-Frank law contains several provisions dealing with compensation. One of the shortest, simplest and most straight forward is Section 955. It requires companies to disclose whether they permit hedging. During the financial crisis, some bankers themselves hedged their compensation, protecting themselves from the most severe effects of their collective mismanagement. More than a quarter of Goldman Sachs 475 partners hedged their compensation from 2007 to 2010.[3]

The importance of hedging disclosure is self-evident. Companies provide stock-based compensation in order to align the interests of employees with those of investors. Stock-based compensation is intended to motivate the employee to promote company prosperity, which is reflected in a rising stock price, which lifts compensation. Hedging delinks those interests. Many companies, including banks, now ban hedging, at least by their most senior employees.[4] A survey found that 95 percent of companies already disclose hedging policies, and the vast majority of these policies involve a ban.[5] Many observers believe hedging should be banned altogether, including proxy advisory firms ISS and Glass Lewis.[6]

While Section 955 does not ban hedging, it calls for disclosure, a minimal advance.

Analysis of Proposed Rule

Section 955 provides that the Commission "require each issuer to disclose . . . whether any employee or member of the board of directors . . . is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities."

To implement this statute, the Commission proposes the following rule: A firm shall "disclose whether [it] permits any employees or directors . . . to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) or otherwise engage in transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of equity securities."

---

[1] "The Wages of Failure," by Lucian Bebchuk, et all, Harvard Law School, (November 2009), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1513522

[2] See, for example, the report of the Financial Crisis Inquiry Commission, available at: http://fcic.law.stanford.edu/

[3] "Stock-hedging lets bankers skirt efforts to overhaul pay," by Eric Dash, New York Times (February 2011), Available at: http://dealbook.nytimes.com/2011/02/05/stock-hedging-lets-bankers-skirt-efforts-to-overhaul-pay/?_r=0

[4] "Stock-hedging lets bankers skirt efforts to overhaul pay," by Eric Dash, New York Times (February 2011), Available at: http://dealbook.nytimes.com/2011/02/05/stock-hedging-lets-bankers-skirt-efforts-to-overhaul-pay/?_r=0

[5] Compensation Advisory Partners survey, (December 2014), available at: http://www.capartners.com/news/204/61/2014-Proxy-Season-Changing-Practices-in-Executive-Compensation-Clawback-Hedging-and-Pledging-Policies

[6] Smith Anderson Securities Alert, February 18 2015, SEC Proposes new Rule Requiring Disclosure of Equity Hedging Policies." first paragraph under "Practical Considerations." http://www.smithlaw.com/newsletter-104.html

As the wording of the proposed rule is nearly identical to the statute, we believe the Commission has fulfilled its rule-making obligation fairly.

Commissioners Michael Piwowar and Daniel Gallagher criticized the proposed rule when the Commission issued it for comment. They urge that hedging disclosure should not apply to "employees that cannot affect the company's share price." Commissioners Piwowar and Gallagher are further concerned that smaller companies will find such disclosure burdensome and even "compel" them to "adopt policies prohibiting hedging." We disagree with their position.

First, the statute does not discriminate among employees. It states that the disclosure applies to "any employee." Commissioners Piwowar and Gallagher acknowledge this when they allow that "the statute technically covers these employees." Second, we disagree with the premise of their concern. All employees contribute to the prosperity of a company and all employees therefore have a corresponding ability to affect share price, especially with poor performance or even rogue behavior. Third, the commissioners' apparent concern with "regulatory burden" is easily answered via disclosure. The proposed rule simply requires publishing a few sentences. Should firms decide that some senior employees be barred from hedging, while some junior employees could be permitted, this is solved with disclosure. Last, implicit in the commissioners' concern that companies may be "compelled" to change their pay practices is an acknowledgement that hedging should be prohibited.

Disguising inconvenient or even embarrassing information is precisely what the SEC is mandated to prevent.

SEC Rulemaking Pace

That the SEC's proposed rule is essentially a restatement of the statute begs the question as to why the Commission expended nearly five years from enactment of the Dodd-Frank law to the time that it will consider implementation of the law's mandate. It cannot be that the statute required this amount of time to decipher. The Commission has promulgated far more complicated rules. It cannot be that the Commission lacks the staff resources to advance such a simple rule. Other financial regulatory agencies have implemented rules at a far faster pace. Public Citizen and other observers have demonstrated the SEC's comparative lack of progress.[7]

Instead, we are left to conclude that a majority of the five commissioners believe it is within their purview to ignore Congressional mandates.

Commissioners Piwowar and Gallagher leave little doubt as to their opposition to central Dodd-Frank provisions.[8] In their most troubling complaint about the proposed hedging disclosure rule,

---

[7] See "Efficiency Nut," by Bartlett Naylor, Public Citizen, (June 2014), available at: http://www.citizen.org/sec-rulemaking-efficiency-report. Also see "Regulatory Tracker," a Davis Polk service, available at: http://www.davispolk.com/dodd-frank/regulatory-tracker/

[8] Commissioner Gallagher likened Dodd-Frank rule-making to "shoveling manure." See ThinkAdvisor, available at: http://www.thinkadvisor.com/2014/10/31/dodd-frank-rulemaking-like-shoveling-manure-secs-g

they explain they oppose the rule because they find it "a prioritization of the Commission's work that we do not share." Even if their technical questions are satisfied in the final rule, they indicate they will vote against the final rule (they say they are "quite concerned") because they contend the staff should have worked on other tasks. Such a position is farcical and is a dereliction of their duty as a congressionally-created body with the mission of protecting investors.

The quibbles of Commissioners Gallagher and Piwowar regarding details or priorities can only be construed as reverse-engineered efforts to accommodate a larger goal to delay if not derail implementation of a congressional command.

But these two individuals do not constitute the majority of the Commission. Commissioners Kara Stein and Luis Aguilar call for strong and expeditious implementation of these pay reforms. They publicly express frustration with the glacial pace of rulemaking.

This leaves Chair White. As the sole manager of the SEC's schedule for rulemaking, the chair bears ultimate responsibility for ensuring progress.

The unjustifiably slow emergence of the hedging disclosure rule epitomizes our broader concern with inaction on the Title IX provisions regarding compensation. The number of compensation reforms the Commission has adopted is precisely one—the say-on-pay provision mandated in Section 951. The others remain fallow.

- Section 953(a), requiring disclosure of pay and performance connections, remains un-proposed.
- On Section 953(b) regarding the CEO/median pay ratio disclosure, the simplest of all Dodd-Frank rules, the Commission lingered three years before finally proposing language and allowed itself a year to finalize it. That year has now elapsed with the Commission delaying its expected completion date by another year.
- Section 954, requiring firms to claw back compensation tied to results that are subsequently shown to be in error, remains un-proposed.
- Section 956, a critical reform requiring regulators to ban incentive pay arrangements that encourage inappropriate risk-taking by banks and investment advisers, is years overdue. It has not yet been finalized despite a statutory deadline of July 2011. In part, this delay is due to a reasonable decision by participating regulators to strengthen the rule proposed in 2011. We support this decision. However, we are concerned that the re-proposal has not yet been issued. Several regulators have signaled important improvements from a previously proposed rule, including Federal Reserve Board Governors Jerome Powell, Stanley Fischer and Daniel Tarullo.[9] New York Federal Reserve Bank President William Dudley also offered an intriguing idea about linking pay to compliance with the law. The SEC, however, has not yet signaled its state of progress in assessing and recommending improvements to the rule. We encourage the SEC to carefully examine the areas of the

---

[9] See for example, speech by Jerome Powell, available at: http://www.federalreserve.gov/newsevents/speech/powell20150120a.htm. Also see "Decimate Wall Street," by Bartlett Naylor, Huffington Post, available at: http://www.huffingtonpost.com/bartlett-naylor/decimate-wall-street_b_6029372.html

rule under its jurisdiction, including both broker-dealers and investment advisers, and work with other regulators to re-propose the rule.

The SEC's inaction makes it difficult to distinguish indecision about policy from opposition to the Dodd-Frank statute's mandates. In most cases, as with the current hedging disclosure rule, there is little for the Commission to decide. The chair must simply press the "go" button.

Congress responded to the financial crisis of 2008 with the Dodd-Frank law. In many ways, we view this law as a half measure, a dilution owing to the prodigious lobbying effort of the same Wall Street industry that caused the crash. The compensation reform measures in Title IX are, for the most part, timid. The hedging disclosure provision is an example. Where the average investor should demand that the government ban hedging that nullifies the entire goal of equity-based compensation, the law simply requires disclosure.

The Commission should move this proposal to a final rule expeditiously, and also advance the other compensation reforms. Otherwise, we are left to wonder if the SEC, charged with protecting investors against Wall Street abuse, may instead be an enabler of that abuse, a concern shared by other important investor advocates.[10]

For questions, please contact Bartlett Naylor at bnaylor@citizen.org, or 202.580.5626.[11]

Sincerely,

Public Citizen

---

[10] Letter from Public Citizen et al, available at:
http://www.consumerfed.org/pdfs/150310_investorprotection_letter.pdf

See, for example, Insurance industry coverage, available at:
http://insurancenewsnet.com/oarticle/2015/03/13/sec-must-prioritize-investor-protection-consumer-groups-say-a-605413.html#.VSQ74xBmP6E

[11] Peter Perenyi contributed research, analysis, and drafting for this comment.

PUBLIC CITIZEN Protecting Health, Safety and Democracy

Nov. 26, 2013

Chair Mary Jo White
Commissioner Luis Aguilar
Commissioner Kara Stein
Commissioner Daniel Gallagher
Commissioner Michael Piwowar
Electronic submission
c/o

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington, DC 20549-1090

Re: Pay Ratio Disclosure, File No. S7-07-13

Dear Chair and Commissioners,

On behalf of more than 300,000 Public Citizen members and supporters, we write to express strong support for the U.S. Securities and Exchange Commission's proposal requiring disclosure of the CEO-to-worker pay ratio as mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Disclosing the ratio of CEO-to-worker pay at individual companies is critical and will provide material information for investors. Significant pay disparities inside a company can harm both employee morale and productivity and can detract from the firm's overall performance. Disclosure of the median employee pay will help investors better understand companies' overall compensation approach to developing their human capital, the economists' term for the aggregate competencies of labor that yield financial value.

Investors will also be able to use CEO-to-worker pay ratios as an additional metric for decision making when evaluating say-on-pay votes and on other executive compensation issues. Pay ratio disclosure helps investors evaluate CEO pay levels in the context of companies' larger internal compensation structures. Investors will be able to see how the ratio changes over time at individual companies and to compare the pay ratio of companies within industries.

As required by Dodd-Frank Section 953(b), the proposed rule appropriately requires companies to disclose the median pay of all of their employees. Given labor market trends, many US publicly traded companies feature a workforce whose majority are based outside the United States, or, when domestic, work part-time. Investors would receive an incomplete picture of their company's pay practices if these foreign-based employees were excluded from the disclosure, or if the part-time workers were translated into full-time-equivalents.

We commend the Commission for proposing to reduce compliance costs as much as possible without reducing the benefits to investors. The proposed rule gives companies considerable flexibility with the option of using sampling or using payroll data to calculate the median. We also support the Commission's proposal to permit companies to provide supplemental disclosure on their overall workforce compensation practices.

Key Issues

Investor interest

Investors support this ratio because it yields information relevant to investment decisions. This should be the guiding principle by which the Commission obliges its statutory mandate to structure the rule. It should be sufficient that investors declare their interest in this information to refute any claim that the rule lacks benefit.

As the *New York Times* editorialized:

"The information is vital. It would allow investors to more accurately judge the effect of pay structures on company performance. It would inform investors' votes on executive pay, because it would be a benchmark for determining whether executive pay is excessive. It would help regulators and policy makers detect bubbles and impending crashes, because those often correlate to widening pay gaps. It would help alert consumers and taxpayers to companies where work forces are underpaid, even as executive pay soars, a circumstance that often requires taxpayer dollars be spent on assistance to low-wage workers."[1]

Explained Tim Macready, chief investment officer of the Christian Super pension fund in Australia, "Executive pay at some companies is excessive and leads to a number of risks, in particular the risk of damage to the company's social license to operate and the risk of worsening employee morale." He explained that the pay ratio is a "useful metric in identifying and dealing with both of these risks."[2] (US regulators should be mindful of the views of international investors in the competition to attract global capital.)

---

[1] New York Times editorial board,*Exposing the Pay Gap*,(Sept. 24, 2013), *available at:* http://www.nytimes.com/2013/09/25/opinion/exposing-the-pay-gap.html?_r=1&

[2] Elliot Blair Smith & Phil Kuntz , *CEO Pay 1,795-to-1 Multiple of Wages Skirts U.S. Law*,(April 30, 2013) Bloomberg, available at: http://www.bloomberg.com/news/2013-04-30/ceo-pay-1-795-to-1-multiple-of-workers-skirts-law-as-sec-delays.html

A number of commenters, as the Commission's proposed rule notes, have already proffered thorough, robust filings.[3]

Benefit of this ratio for investors

While the statute does not elaborate on the purpose for providing the ratio, investors can use this ratio as they use other figures that are provided for company comparisons such as earnings growth, the price/earnings multiple, and others. In virtually every form of financial or corporate analysis, ratios are necessary. The pay ratio is important because it provides CEO pay with context, similar to unit pricing in a grocery store. The ratio can be used to compare compensation between CEOs, pay with growth, or pay with profits.[4]

Given these and many other benefits to investors, it cannot fairly be claimed that the CEO pay ratio yields no utility, as many of its opponents argued. Further, should the eventual rule be challenged in court, it would be clear that the Commission adequately considered the existence of declared value of this pay ratio to investors.

Excessive CEO and senior management pay can detract from shareholder value

There is abundant reason for shareholders to evaluate CEO pay, and the pay of the workforce.

CEO pay is not a trivial figure. The percentage of corporate profits spent on senior executive pay has doubled from 5% in 1990 to 10% in 2010.[5] Moreover, excessive CEO pay is associated with poor performance.[6] Excessive pay is associated with fraud.[7] Destructive incentive dynamics figured at the center of the Wall Street crash, where large bonuses turned on speculative trading.[8]

The pay ratio can also open a window into less tangible issues, such as morale, as a wide pay gap can translate into productivity problems at a corporate entity.[9] It is natural to express anger at pay inequity.[10]

---

[3] We urge special attention to the submission of the AFL-CIO Office of Investment. This letter summarizes arguments and contains the proposal for statistical sampling, that the Commission has adopted. See comment letter, available at: http://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-78.pdf

[4] The utility of the pay ratio is succinctly explained in a comment letter from a portfolio manager with the Roylan Fund. See B.C. Collins, Roylan Fund, comment letter, , available at: http://www.sec.gov/comments/s7-07-13/s70713-88.htm

[5] Lucian Bebchuck, *The CEO Pay Slice,* , Harvard University Law School, (September, 2010), available at: http://www.law.harvard.edu/faculty/bebchuk/pdfs/Bebchuk-Cremers-Peyer_CEO-Pay-Slice_Sept2010.pdf

[6] Lucian Bebchuck, *The CEO Pay Slice,* , Harvard University Law School, (September, 2010), available at: http://www.law.harvard.edu/faculty/bebchuk/pdfs/Bebchuk-Cremers-Peyer_CEO-Pay-Slice_Sept2010.pdf

[7] Janice Kay McClendon, *Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders' Interests and Promote Corporate Long-Term Productivity* (Winter 2004). Wake Forest Law Review, Vol. 39, No. 4, 2004.

[8] Lucian Bebchuk, Alma Cohen, and Holger Spamann, *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008*, Yale Journal on Regulation, Vol. 27, 2010, pp. 257-282.

[9] Damon Silvers, policy director, AFL-CIO, *Testimony before the House Subcommmittee on Capital Markets*, available at: http://www.aflcio.org/Legislation-and-Politics/Testimonies/Silvers-before-subcommittee-on-capital-markets. Also: James Cotton, *Toward Fairness in Compensation of Management and Labor: Compensation Ratios, A Proposal for Disclosure*, Northern Illinois University Law Review, 1997.

Jim Collins, then a professor at Stanford Graduate School of Business, surveyed 1,500 companies over a 15-year period and identified those with superior financial performance. Not one of the "great" companies he identified had a high-paid, "celebrity" CEO, as he termed them.[11] "Celebrity CEOs turn a company into one genius with 1,000 helpers," taking focus away from the motivation and creativity needed from all of a company's employees, explained Collins.[12]

Desirable ratios

The ratio of CEO-to-worker pay has long been recognized as an important figure. Investment banker J.P. Morgan argued that CEO pay should not exceed 20 times the average worker's pay. Management consultant Peter Drucker advised clients that a 20-to-1 salary ratio is the limit beyond which they cannot go if they don't want resentment and falling morale to hit their companies.[13] Switzerland, generally viewed as a conservative pro-business bastion, recently considered a national law requiring a 12-1 ratio between the best and least paid workers at a firm.[14]

The ratio is not difficult to calculate

There appears to be some misunderstanding or misleading statements about how a median-paid employee is identified. According to the staff's discussion in the proposed rule, the following projected compliance costs were submitted by agents of the six corporations that met with representatives of the Commission:

- Approximately 201 to 500 hours per year, plus significant costs;
- $3 to $6.5 million for a multinational manufacturing company with 90 separate payrolls;
- $4.725 million for a multinational consumer products company (including an estimated 50 hours per country for employees located in 80 countries);
- $100 million dollars for a multinational company; and
- $350,000 to implement plus $100,000 a year for ongoing compliance for a global technology company."[15]

---

[10] Prof. Frans de Waal, *Moral Behavior in Animals*, TED Talk, (April, 2012) available at -http://www.youtube.com/watch?v=-KSryJXDpZo

[11] Jim Collins, *Good to Great: Why Some Companies Make the Leap . . . and Others Don't*, (HarperBusiness, 2001).

[12] *Ibid.*

[13] Drucker Institute, *Comment Letter to the SEC on Section 953(b) of Dodd-Frank*, (February 17, 2011), http://thedx.druckerinstitute.com/wp-content/uploads/2011/02/SECcomment.pdf.; also, Lucian Bebchuk and Yaniv Grinstein, *The Growth of Executive Pay*, Oxford Review of Economic Policy, Vol 21 (2005).

[14] In a national referendum November 24, 2013, the proposal was defeated, with 34.7 percent of the population favoring the cap. The citizen referendum faced opposition from business groups and the Swiss Parliament. See John Hooper *Switzerland votes against cap on executive pay* The Guardian (Nov. 24, 2013), available at: http://www.theguardian.com/world/2013/nov/24/switzerland-votes-against-cap-executive-pay

[15] Federal Register, Oct. 1, 2013, at p. 60587; available at: http://www.gpo.gov/fdsys/pkg/FR-2013-10-01/pdf/2013-23073.pdf

The six companies whose agents met with representatives of the SEC were: IBM, Johnson & Johnson, General Electric, Motorola Solutions, Exxon and Emerson Electric.[16] IBM qualifies as a "global technology" firm and may be assumed as the firm estimating compliance cost of $100,000. Johnson & Johnson presumably is the consumer products firm, estimating the cost at $4.725 million.[17] General Electric and Emerson Electronics both might be described as multinational manufacturing companies. Motorola Solutions is a telecommunications firm. By process of elimination, it appears that it is Exxon that claims that compliance would cost $100,000,000.00. Exxon employs 79,000 employees.[18] Exxon is claiming, in effect, that it would cost more than $1,000 per employee to calculate which one is the median-paid employee. Public Citizen does not find this figure to be credible.

Perhaps these firm representatives mistakenly believe they must count the pay of each and every employee. But it would not be necessary to calculate the exact pay of each employee. If a firm with 100,000 workers pays 10,000 of them a minimum wage and employs them part-time, then this simply means the bottom 10% is established. The specific compensation of each of these in the bottom 10% need employees not be identified. If 30,000 are full-time and paid minimum wage, then the bottom 40% is established. If the next best paid 20,000 employees earn more than the minimum wage, then only about 5-10 percent of them need be examined to identify which is the median.

Moreover, if one reverse-engineers the ratio, the acceptance of an integer, or whole number means that a range of employee pay will, during the arithmetic division, yield the same integer.[19] We believe that use of a whole number will enable a firm to shorten the identification of the median because it will only need to look at a range of compensations. That will render unnecessary the identification of a single employee. It is the ratio that is important. Using a whole number in the ratio simplifies identification of the median in the following way. If the CEO is paid $7.25 million, and the exact median-paid employee makes $49,235.25, the ratio would be 147.251654. It would be sufficient for the company to report 147. This simplifies identification of the median since anyone making between $49,155.23 and $49,484.39 would actually generate the same ratio of 147, because this compensation falls between 146.51 and 147.49. In other words, if there are 1,000 employees who fall in this range, the effort is complete. This process is iterative. It is iterative in that once the sampling points to a pool of workers, the pool itself can be sampled. Of minor note, the lower the gap between the CEO and median-paid employee, the larger the pool from which the median is identified. The rounding of a lower ratio, such as 85, is .99/85 or 1.1 percent. That means median salaries within a 1.1

[16] Executive Compensation: Title IX Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, meetings, visited Nov. 13, 2013; available at: http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml

[17] Of these, only Johnson & Johnson is a consumer products company, although it claims to operate in 60 and not 80 countries on its website. See the firm's website: http://www.jnj.com/our-news-center/backgrounder

[18] Exxon annual report, at p. 1, available at: http://www.sec.gov/Archives/edgar/data/34088/000003408813000011/xom10k2012.htm

[19] The statute requires that a firm determine, "(A) the median of the annual total compensation of all employees of the issuer, except the chief executive officer (or any equivalent position) of the issuer." The statute does not state that this median is exactly one individual.

percent range (+/- 0.55%) all yield the same ratio of 85. With a higher ratio, such as 1,335, the range of integer medians is much smaller, as .99/1,335 = 0.07% of the median salary.

Industry lobbying

The extensive industry lobbying effort to claim that the calculation of the ratio is complicated may be motivated by a wish to protect high senior management pay. Said Phil Angelides, who led the Financial Crisis Inquiry Commission that investigated the economic collapse of 2008, "The fact that corporate executives wouldn't want to display the number speaks volumes."[20]

Public Citizen has documented the lobbying effort. A Public Citizen report in 2011 found that industry lobbyists have spent more than $4.5 million trying to avoid the rule's completion.[21] This figure has undoubtedly grown in the two years since publication. Given that IBM contends it will cost $100,000 a year to comply, which we believe is exaggerated, that means the lobbying effort for one year could pay for the compliance costs that 45 companies of IBM's size would bear. IBM, of note, is the nation's second largest employer.[22]

Public Citizen respectfully requests the Commission consider our comments. The Commission serves investors, and Section 953b will serve investors, as the already prodigious comment docket attests. We believe every commissioner should approve this final rule.

Sincerely,

Lisa Gilbert, director of Public Citizen's Congress Watch division

Bartlett Naylor, financial policy advocate of Public Citizen's Congress Watch division

---

[20]Eliot Blair Smith and Phil Kuntz *CEO Pay 1,795-to-1 Multiple of Wages Skirts U.S. Law,* Bloomberg (April 30, 2013), available at: http://www.bloomberg.com/news/2013-04-30/ceo-pay-1-795-to-1-multiple-of-workers-skirts-law-as-sec-delays.html

[21] The lobbying figures cover disclosures that may include other policy issues. See: Negah Mouzoon and Bartlett Naylor *Two Cents*, Public Citizen, (April, 2011) available at: http://www.citizen.org/documents/Two-Cents.pdf

[22]IBM *Annual Report*, (2012), available at: http://www.sec.gov/Archives/edgar/data/51143/000104746913001698/a2212340z10-k.htm; also, Bureau of Labor Statistics, *Employment by major industry sector*, visited Nov. 14, 2013) available at: http://www.statisticbrain.com/u-s-largest-employers/