Council of Institutional Investors®
The voice of corporate governance

Via E-Mail

September 19, 2024

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

Re: File No. S7-2024-03

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII). CII is a nonprofit, nonpartisan association of United States (U.S.) public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of more than $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with more than $4 trillion in assets, and a range of asset managers with more than $50 trillion in assets under management.[1]

This letter is in response to the Securities and Exchange Commission's (SEC or Commission) invitation to comment on its semiannual regulatory agenda (Agenda).[2] In responding to the Agenda, we note that CII's current SEC rulemaking priorities fall into the following three categories: (1) Investor Rights and Protections; (2) Corporate Disclosure; and (3) Market Systems & Structure.[3]

1. Investor Rights and Protections

We include under this heading[4] our February 29, 2024, petition for rulemaking regarding traceability of shares (2024 Petition).[5] We believe, consistent with the 2024 Petition, the SEC

[1] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.
[2] Regulatory Flexibility Agenda, Securities Act Release No. 11,287, Exchange Act Release No. 100,157, Investment Adviser Act Release No. 6,605, Investment Company Act Release No. 35,194, 89 Fed. Reg. 66,976 (Aug. 15, 2024), https://www.federalregister.gov/documents/2024/08/16/2024-16470/regulatory-flexibility-agenda.
[3] *See* CII Advocacy Priorities (as of Sept. 18, 2024), https://www.cii.org/advocacy_priorities.
[4] *See* CII Advocacy Priorities, Investor Rights & Protections (listing CII advocacy for "[e]nsuring the right to recover losses under Section 11").
[5] *See* Jeffrey P. Mahoney, General Counsel, Counsel of Institutional Investors to Ms. Vanessa A. Countryman,

should add a project to its Agenda that would protect investor rights to recover losses under Section 11 of the Securities Act of 1933 (Section 11).[6]

Protecting Investor Rights under Section 11

The 2024 Petition states in relevant part:

> *The Council of Institutional Investors . . . respectfully asks the Securities and Exchange Commission . . . to initiate a rulemaking to protect investors' rights under Section 11 of the Securities Act of 1933 . . . by endorsing and requiring technological solutions to facilitate the tracing of shares sold into the marketplace by direct listings and traditional initial public offerings (IPOs).*
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> . . . .
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> On multiple occasions in the past, the Council has urged the Commission, consistent with our membership-approved policies, to use available technology to protect investors through comprehensive reform of the so-called "proxy plumbing" system. The Council continues to believe that a comprehensive update of the U.S. proxy system, while continuing to make short-term improvements, would be the best way forward for investor protection.
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> That said, there is an immediate need to respond to the recent U.S. Supreme Court (Court) decision in *Slack Technologies, LLC v. Pirani* (*Slack*), 143 S. Ct. 542 (2023), which affirmed, in a suit brought under Section 11, that the shareholder must be able to "trace" his or her shares to a registration statement covering those shares. The problem is acute, given the ability of investors to purchase shares issued through direct listings, as well as IPOs, thus raising new issues regarding traceability of shares brought to market through one medium rather than the other.
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> . . . .
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> Section 11 provides a fundamental protection for investors in new, publicly traded companies because it creates a "virtually absolute" liability for companies, their directors, underwriters, and advisors if there is any misrepresentation or omission of any material information in a registration statement. Section 11 is arguably the single most important investor protection provision in the entirety of the federal securities laws.
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> Investors seeking to pursue remedies under Section 11 must establish that they purchased shares pursuant to a registration statement, thus demonstrating that their shares are "traceable" to that statement. Until recently, traceability was not an issue,

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Secretary, Securities and Exchange Commission (Feb. 29, 2024), https://www.cii.org//Files/Correspondence/February%2029%202024%20SEC%20petition%20for%20Section%2011%20FINAL.pdf.

[6] *See* Section 11, Securities Act of 1933, Cornell L. Sch. LII (last visited Sept. 18, 2024), *available at* https://www.law.cornell.edu/wex/section_11.

> given that underwriters generally imposed a lockup period for insiders and early investors after a registration statement became effective. Such a lockup period prevented insiders and early investors from selling unregistered shares acquired before the public offering.
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> With the advent of direct listings, it became possible for unregistered shares to be sold alongside shares issued pursuant to a registration statement, thus complicating questions of traceability for Section 11 plaintiffs. Last June in *Slack* the Court found that, notwithstanding these multiple sources of shares being sold to the public, a Section 11 plaintiff must nonetheless establish that his or her shares were purchased pursuant to a registration statement and not through a direct listing of unregistered shares.
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> We believe the *Slack* decision underscores the need for the Commission to take prompt action related to our long-standing request to protect investors' rights under Section 11. One potential response was suggested by a working group of academics, former SEC officials and legal scholars who proposed that the Commission amend SEC Rule 144 to limit sales of unregistered securities for a certain period of time after the effectiveness of a registration statement . . . . The working group proposed this approach as a way to potentially balance the interests of insiders and early investors in being able to sell unregistered shares against the interest of public shareholders in having an effective remedy under Section 11. Last October, CII filed comments in general support of that concept.
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> [Our 2024 Petition] . . . urge[s] an alternative approach, namely, requiring the use of technology that would facilitate tracing to deal with situations such as occur in Section 11 cases. To put the point in context, there is no shortage of alternatives that the Commission could pursue to re-invigorate Section 11. The issue is not whether, but how to do so.
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> . . . Two potential approaches have been recently identified by former SEC Chair Jay Clayton and former Commissioner Joseph A. Grundfest.[7] In a brief filed as *amici curiae* in the *Slack* case they stated that the Commission could:
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> 1. Require that registered and exempt shares offered in a direct listing trade with differentiated tickers, at least until expiration of the relevant Section 11 statute of limitations; or
> 2. Migrate the entire clearance and settlement system to a distributed ledger system or to other mechanisms to allow the tracing of individual shares as individual shares, and not as fractional interests in larger commingled electronic book entry accounts.

[7] *See* Brief for amici curiae Jay Clayton and Joseph A. Grundfest in Slack Technologies, LLC v. Pirani, U.S. (2023) (No. 22-200) at 31-34, *available at* https://www.supremecourt.gov/DocketPDF/22/22-200/253996/20230203160500846_Brief%20of%20Amici%20Curiae%20The%20Honorable%20Jay%20Clayton%20and%20The%20Honorable%20Joseph%20A.%20Grundfest%20in%20Support%20of%20Petitioners.pdf.

> We note that the second more ambitious approach is aligned with the recommendation CII submitted to the SEC in connection with its 2018 Roundtable on the Proxy Process.
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> A third potential approach for our proposed rulemaking was described in a recent study by Professors John C. Coffee, Jr., and Joshua Mitts ("C&M Study"). The C&M Study advocates various steps using modern computing power to trace the purchase of shares to an allegedly misleading registration statement. As they point out, broker-dealers, exchanges and the Financial Industry Regulatory Authority (FINRA) must all maintain detailed, timestamped transactional records, which show when securities in one account are transferred to another account.
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> As these three proposed technological solutions illustrate, the Commission has a number of potential options available to update and enhance the protections afforded under Section 11. *The Council thus asks the Commission to open a rulemaking that endorses and requires technological solutions that would facilitate the tracing or attribution of individual shares to a registration statement in connection with a direct listing or a traditional IPO*.[8]

On a related note, we commend the Commission for its completed action on its rulemaking entitled "Special Purpose Acquisition Companies, Shell Companies, and Projections" (SPAC Rule)[9] We generally support the SPAC Rule.[10] We are particularly supportive of the requirement that "a target company in a registered de-SPAC transaction is a co-registrant on the registration statement used for the de-SPAC transaction such that the target company will be subject to liability under section 11 of the Securities Act . . . ."[11]

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[8] *See* Jeffrey P. Mahoney, General Counsel, Counsel of Institutional Investors to Ms. Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 1-6 (emphasis added and footnotes omitted).

[9] *See* 89 Fed. Reg. at 66,977, 66,979; *see* Special Propose Acquisition Companies, Shell Companies, and Projections, Securities Act Release No. 11,265, Exchange Act Release No. 99,418, Investment Company Act Release No. 35,096, 89 Fed. Reg. 14,158 (Feb. 23, 2024), https://www.federalregister.gov/documents/2024/02/26/2024-01853/special-purpose-acquisition-companies-shell-companies-and-projections.

[10] *See* Letter from Glenn Davis, Deputy Director, CII to Secretary, Vanessa A. Countryman, Securities and Exchange Commission 2 (June 9, 2022), https://www.cii.org/files/Correspondence/06-09-22%20CII%20letter%20to%20SEC%20on%20SPAC%20reform(1).pdf ("we welcome the Proposal as meaningful reform to address current gaps in transparency and investor protections between the SPAC route to the public equity markets and other routes"); Letter from Jeffrey P. Mahoney, General Counsel, CII to Secretary, Securities and Exchange Commission 3 (July 18, 2024), https://www.cii.org//Files/Correspondence/July%2018%202024%20letter%20to%20SEC%20regarding%20SPACs%20(final).pdf ("many SPACs appear to have challenges in following . . . corporate governance principles, . . . which are critically important for the fair and optimal use of disinterested SPAC investors' capital [and] [w]hile we applaud the SEC's new requirements to provide greater transparency regarding those challenges, we believe that their continued existence has significant implications for the protection of investors and the public interest").

[11] 89 Fed. Reg. at 14,164; *see* Letter from Glenn Davis, Deputy Director, CII to Secretary, Vanessa A. Countryman, Securities and Exchange Commission at 2 ("We generally agree with the Commission on the need to: . . . ensure that underwriter status and liability under Section 11 of the Securities Act of 1933 apply to SPAC underwriters who

A recent legal analysis of the SPAC Rule indicates that shareholders bringing meritorious Section 11 claims against SPACs "will still have to deal with Section 11's strict procedural requirements, including establishing that they purchased shares traceable to the allegedly defective registration statement [and] . . . *there may be shares issued under multiple registration statements, making tracing difficult*."[12] Thus, in our view, the SPAC Rule increases the urgency of the Commission to add a project to its Agenda that would protect investor rights to recover losses under Section 11.

2. Corporate Disclosure

We include under this heading our continued support for the SEC adding a new project to the Agenda to close a loophole in regulation governing the use of financial measures for executive compensation based on something other than Generally Accepted Accounting Principles (GAAP) (Non-GAAP Financial Measures).[13]

Non-GAAP Financial Measures

CII reiterates the request it first made in a 2019 rulemaking petition (2019 Petition) that the Commission add a new project to its Agenda to require disclosure of a (1) quantitative reconciliation to GAAP of Non-GAAP Financial Measures used to determine executive compensation; and (2) a qualitative description of why the Non-GAAP Financial Measures are better for determining executive pay than GAAP financial measures.[14]

We note that "[n]on-GAAP disclosures are one of the most common issues in financial reporting." [15] And "almost all large publicly traded companies make them, and such disclosures typically paint a more positive picture of corporate performance than comparable GAAP

participated in the distribution of shares by taking steps to facilitate the de-SPAC"); *see generally,* The Further Erosion of Investor Protection with Andrew Tuch, Voice of Corp. Governance (Dec. 19, 2022), https://www.cii.org/podcasts (discussing Section 11 liability and SPACs).

[12] Jeffrey Steinfeld et. al., SPAC Rules Broaden Liability, Weaken Safe Harbors: Legal Insight, Bloomberg Law, July 15, 2024 (on file with CII) (emphasis added).

[13] *See* CII Advocacy Priorities, Corporate Disclosure (listing CII advocacy for "Transparency of executive compensation").

[14] *See* Letter from Kenneth A. Bertsch, Executive Director, CII et al. to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission 1 (Apr. 29, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/20190426%20CII%20Petition%20revised%20on%20non-GAAP%20financials%20in%20proxy%20statement%20CDAs.pdf ("The Council of Institutional Investors respectfully submits this petition to the Securities and Exchange Commission (Commission) requesting that the Commission (1) initiate a rule change to amend Item 402(b) of Regulation S-K [17 CFR 229.402(b)] . . . to eliminate Instruction 5; and (2) revise the Division of Corporation Finance's Compliance & Disclosure Interpretations on 'Non-GAAP Financial Measures' consistent with the aforementioned amendment and to provide that all non-GAAP financial measures presented in the proxy statement Compensation Discussion & Analysis (CD&A) are subject to the requirements of Regulation G [17 CFR 244.101-102] and Item 10(e) of Regulation S-K [17 CFR 10(c)] and that the required reconciliation shall be included within the proxy statement or made accessible through a hyperlink in the CD&A").

[15] *See* Olga Usvyatsky, Understanding Changes to Non-GAAP Reporting, Calcbench (Aug. 21, 2023), https://www.calcbench.com/blog/post/7262820543749816 32/understanding-changes-to-non-gaap-reporting.

disclosures."[16] And many of these same companies use non-GAAP earnings as a key criterion in setting executive compensation.[17] The result is that currently the "use of non-GAAP adjustments to determine incentive plan payouts is a common practice among companies of all sizes and industry sectors."[18]

A 2023 research article co-authored by the SEC's former Chief Economist and Director of the Division of Economic and Risk Analysis provides empirical evidence indicating that companies are engaging in an opportunistic use of non-GAAP earnings to justify higher executive compensation.[19] The article recommends, generally consistent with our 2019 Petition, that:

> [C]ompensation committees of all public companies might consider (i) prominently disclosing the amount of difference between the non-GAAP criteria used by the committee and the relevant GAAP numbers; and (ii) providing a justification for why the committee chose to use non-GAAP criteria in setting executive compensation.[20]

More recently, prominent financial analyst and accountant Jack Ciesielski endorsed CII's 2019 Petition commenting:

> "I think it's a great idea that they include a reconciliation of the GAAP-to-non-GAAP measures used to award compensation based on such targets," . . . .
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> "It's only fair to let the owners of the company see the targets that managements have decided should determine their own pay. It's almost like giving them a blank check, ...''[21]

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[16] *See id.*; Nicholas Guest et al., Why Do Large Positive Non-GAAP Earnings Adjustments Predict Abnormal High CEO Pay?, Harv. L. Sch. F. On Corp. Governance (Feb. 16, 2023), https://corpgov.law.harvard.edu/2023/02/16/why-do-large-positive-non-gaap-earnings-adjustments-predict-abnormally-high-ceo-pay/ ("About two-thirds of S&P 500 firms announce non-GAAP earnings, which are 23% larger than GAAP earnings on average.").

[17] *See* Nicholas Guest et al., Why Do Large Positive Non-GAAP Earnings Adjustments Predict Abnormal High CEO Pay?, Harv. L. Sch. F. On Corp. Governance ("Moreover, many of these same companies use non-GAAP earnings as a key criterion in setting CEO pay").

[18] Mike Kesner & Steve Pakela, Impact of Non-GAAP Earnings and Adjustments on Incentive Plans Payouts: Heightened Scrutiny Ahead?, Pay Governance (Dec. 18, 2023), https://www.paygovernance.com/viewpoints/impact-of-non-gaap-earnings-and-adjustments-on-incentive-plan-payouts-heightened-scrutiny-ahead.

[19] *See* Nicholas Guest et al., Why Do Large Positive Non-GAAP Earnings Adjustments Predict Abnormal High CEO Pay?, Harv. L. Sch. F. On Corp. Governance ("it appears likely that an economically meaningful fraction of CEO pay, especially of CEOs with a heightened need to justify their pay, is attributable to opportunistic use of non-GAAP earnings [and] . . . legitimizing high CEO pay appears to be one of potentially multiple reasons for firms to use non-GAAP earnings in contracting").

[20] Nicholas Guest et al., Why Do Large Positive Non-GAAP Earnings Adjustments Predict Abnormal High CEO Pay?, 97(6) Acct. Rev. 297 (2022), https://publications.aaahq.org/accounting-review/article-abstract/97/6/297/353/Why-Do-Large-Positive-Non-GAAP-Earnings.

[21] Soyoung Ho, Institutional Investors Once Again Urge SEC to Write Rule on Non-GAAP Measures for Executive Pay, Acct. & Compliance Alert, Thomson Reuters, Tax & Acct. (Aug. 31, 2023),

In addition, in October 2023 Institutional Shareholder Services (ISS) summarized the results of its 2023 Global Benchmark Policy Survey, which opened on August 29 and closed on September 21, 2023 (ISS Survey)."[22] We believe several of the findings of the ISS Survey support the need for our 2019 Petition, including:

- "U.S. companies *routinely* use non-GAAP metrics in their incentive pay programs, and the performance results (and consequently the payouts) *can be significantly* affected by the non-GAAP adjustments approved by the board."[23]
- *"[M]any* companies do not disclose in the proxy statement a line-item reconciliation of non-GAAP to GAAP for incentive program metrics."[24]
- "*Recent events resulting in increased investor scrutiny of non-GAAP adjustments* include . . . adjustments related to the Russia-Ukraine conflict, and costs arising from litigation."[25]
- A *growing number* of investors believe that disclosure of line-item reconciliation is *needed to make an informed assessment of executives' incentive pay*."[26]
- "When asked if companies should disclose a line-item reconciliation of non-GAAP adjustments to incentive pay metrics in the proxy statement, *60 percent of investor respondents replied that line-item reconciliations should always be disclosed . . . .*"[27]

A similar survey by Glass Lewis revealed the following similar results:

> While the U.S. Securities and Exchange Commission (SEC) has issued guidelines seeking to rein in aggressive reporting amongst U.S. companies, there is no requirement to disclose Non-GAAP-to-GAAP reconciliation in the proxy statement. With that in mind, we asked if the absence of explanatory disclosure should be a factor when forming Say on Pay vote recommendations in situations where incentive outcomes are materially impacted by the use of adjusted Non-GAAP results. *An overwhelming majority of investors responded that "Yes," it would definitely impact their vote decision to some extent* (81.0%, vs 51.9% of non-investors), with more than half viewing it as "a strong factor" (53.4%, vs 23.1% of non-investors).[28]

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https://tax.thomsonreuters.com/news/institutional-investors-once-again-urge-sec-to-write-rule-on-non-gaap-measures-for-executive-pay/.

[22] 2023 ISS Global Benchmark Policy Survey, Summary of Results, ISSGovernance (Oct. 31, 2023), https://www.issgovernance.com/file/policy/2023/2023-ISS-Benchmark-Survey-Summary.pdf.

[23] *Id.* at 9 (emphasis added).

[24] *Id.* (emphasis added).

[25] *Id.* (emphasis added).

[26] *Id.* (emphasis added).

[27] *Id.* at 5 (emphasis added).

[28] Client Policy Survey 2023, Results and Findings, Glass Lewis 41 (2023), https://www.glasslewis.com/wp-content/uploads/2023/11/Glass-Lewis-Client-Policy-Survey-2023-Results-and-Key-Findings.pdf (emphasis added).

In addition, a 2024 report by *Intelligize* discussing the SEC's Pay for Performance rule[29] and the 2019 Petition, concludes that "as shareholders' understanding of executive compensation and related performance measures rises, there will be increased scrutiny of the relationship between non-GAAP financial performance measurers and executive compensation."[30] And in a 2024 Proxy Season Briefing by *Glass Lewis* it was noted that of the four failed say-on-pay proposals at S&P 500 companies there were "concerns around controversial non-GAAP adjustments to incentive plan performance results" at Norfolk Southern.[31] And per our review of Norfolk Southern's proxy statement there is no quantitative reconciliation of its "ROAIC" Non-GAAP Financial Measure for determining executive compensation.[32]

For all the above reasons, we continue to believe it is imperative that the SEC promptly propose a rule to require, at a minimum, that companies include a hyperlink to a quantitative GAAP reconciliation for any Non-GAAP Financial Measures contained in their proxy statement.[33]

3. Market Systems & Structure

We include under this heading[34] our support for the "*Division of Trading and Markets* Final Rule Stage"[35] categorization of the SEC's Agenda projects on "Regulation Best Execution,"[36] and "Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders" (Regulation NMS).[37] We also include under this heading[38] a reiteration of our request that the SEC consider giving a higher priority to its Agenda project on "Proxy Process Amendments."[39]

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[29] *See* Pay Versus Performance, Exchange Act Release No. 95,607 (Aug. 15, 2022), https://www.federalregister.gov/documents/2022/09/08/2022-18771/pay-versus-performance.
[30] Pay Versus Performance: A look at Non-GAAP Financial Performance Measures, Executive Compensation: Not Everyone Is Happy, Intelligize 7 (Jan. 2024) (on file with CII).
[31] 2024 Proxy Season Briefing, Global Trends, Glass Lewis 10 (2024) (on file with CII).
[32] 2024 Notice of the Annual Meeting of Shareholders and Proxy Statement, Norfolk Southern 60, 105 (2014), https://assets.website-files.com/65dcdda590206c0720e0f864/65fad4d1cf40c8e26fac7b0e_Norfolk%20Southern%202024%20Proxy%20Statement.pdf.
[33] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 7 (Mar. 11, 2024), https://www.cii.org/files/issues_and_advocacy/correspondence/2024/March%2011,%202024%20Reg%20Flex%20Letter.pdf ("CII believes it is imperative that the SEC propose a rule to require, at a minimum, that companies include a hyperlink to a GAAP reconciliation for any non-GAAP pay targets contained in their CD&A.").
[34] *See* CII Advocacy Priorities, Market Systems & Structure (referencing "Stock exchange operations and governance").
[35] 89 Fed. Reg. at 66,981.
[36] *See* Regulation Best Execution, Exchange Act Release No. 96,496, 88 Fed. Reg. 5,440 (proposed Jan. 27, 2023), https://www.federalregister.gov/documents/2023/01/27/2022-27644/regulation-best-execution.
[37] *See* Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 96,494, 87 Fed. Reg. 80,266 (proposed Dec. 29, 2022), https://www.federalregister.gov/documents/2022/12/29/2022-27616/regulation-nms-minimum-pricing-incrementsaccess-fees-and-transparency-of-better-priced-orders.
[38] *See* CII Advocacy Priorities, Market Systems & Structure (listing CII advocacy for "End-to end vote confirmation").
[39] Agency Rule List – Spring 2024, Securities and Exchange Commission, Off. Info. & Reg. Aff., Off. Mgmt. & Budget (last visited Sept. 15, 2024),

Regulation Best Execution

Since 1998 CII has had a membership-approved policy that emphasizes the importance of best execution. That policy states in relevant part:

> We . . . have the broader duty to communicate the interests and desires of the institutional investor community to regulators, to the public and to the industry regarding trading practices and commissions.
> . . . [B]rokerage industry practices . . . make it difficult to break out the exact costs of services (for trade execution, research or other things), may be antithetical to the fiduciary obligation of obtaining *best execution*, and hold too much potential for *conflicts of interest* and abuses.
> . . . .
> Clarity and transparency of disclosure of all money management and brokerage arrangements is essential, and it is up to plan sponsors to require it. Simple reliance on brokers, money managers and consultants for volunteered information is insufficient to discharge the obligations of plan fiduciaries. Plan sponsors should require regular reports and affirmative representations that fiduciaries are pursuing *best execution* in their trading practices.[40]

In CII's comment letter in response to the Regulation Best Execution proposal, we stated:

> Consistent with our policy on Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture, which includes two references to "best execution," we generally agree with Chair [Gary] Gensler that a "best execution standard at the Commission level . . . would lead to better execution for retail and institutional investors." We, however, have concerns with two provisions of the BestEx Proposal and their potential impact on brokers' potential best execution obligations for institutional investors: Proposed exemption for an institutional customer; and omission of a proposed requirement for order-by-order decision making.[41]

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https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPubId=202404&showStage=longterm&agencyCd=3235&csrf_token=4E8C20A731E10FC156AA0644D84496373A2F5C35DEE25ADCD3F39AF24E1081DD194DF46D730C958E19F0F0848A3BC971FBBA (categorizing "Proxy Process Amendments" in "Long-Term Actions"); *see, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 13 (Sept. 7, 2022), https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%207%202022%20Reg%20Flex%20Letter%20(final).pdf ("we believe the SEC should prioritize as a next step improving proxy plumbing by addressing end-to-end vote confirmation").

[40] CII, Policies on Other Issues, Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture (adopted Mar. 31, 1998), https://www.cii.org/policies_other_issues#principles_trading_commission_softdollar.

[41] Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 5 (Mar. 30, 2023) (footnote omitted), https://www.cii.org/Files/Correspondence/03-30-2023-Equity-Market-Structure-final.pdf.

In July 2023, we participated in a meeting with SEC Chair Gensler and staff in which our two concerns with the Regulation Best Execution proposal were discussed.[42] We are confident that those concerns will be adequately addressed, and we look forward to the issuance of the final rule.

Regulation NMS

Our 1998 membership-approved policy emphasizing the importance of best execution has also been a basis for our long-standing concerns that the structure of stock exchange access fees and rebates may present conflicts of interest.[43]

In CII's comment letter in response to the Regulation NMS proposal, we explained:

> Consistent with our policy . . ., CII has long raised concerns that the structure of stock exchange access fees and rebates may present conflicts of interest for broker-dealers affecting their order routing decisions and lowering the execution quality for institutional investors. That continuing concern leads us to generally support the NMS Proposal provisions described as "Lower Access Fee Cap" and "Exchange Fees and Rebates Determinable at the Time of Execution." We agree with SEC Chair Gary Gensler that when "[t]aken together, this transparency and change to access fee caps would drive efficiency, competition, and fairness in our markets" to the benefit of long-term institutional investors.[44]

We applaud the SEC for adopting a final rule on Regulation NMS.[45] We are especially pleased that the final rule addresses the two issues we emphasized in our comment letter. More specifically, we support the amendments to Rule 610 that reduces the level of the access fee caps.[46] In explaining the basis those amendments the final rule states:

> . . . [T]he reduced access fee caps in amended Rule 610(c) *will likely reduce the rebates paid and, as a result, the amended access fee caps will reduce the distortions created by the existing fee structures that use access fees as a means to fund the payment of rebates in the market*.[47]

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[42] *See* Memorandum from the Office of Public Engagement to File Nos.: S7-29-22, S7-30-22, S7-32-22 (July 17, 2023), https://www.sec.gov/comments/s7-29-22/s72922-225739-473082.pdf.

[43] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, CII to Brent J. Fields, Secretary, Securities and Exchange Commission 2 (May 10, 2018), https://www.sec.gov/comments/s7-05-18/s70518-3621501-162362.pdf ("We are particularly troubled by evidence cited by the Commission that 'shows lower execution quality, in terms of reduced probability of execution or increased time to execution, for non-marketable limit orders on exchanges that pay high rebates [and] [t]hus broker-dealers may route orders to exchanges that have the best quoted prices but are suboptimal for customers in other ways because orders are either less likely or take longer to execute.'").

[44] Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 2-3 (footnotes omitted).

[45] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 101,070 (Sept. 18, 2024), Final Rule - Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders (sec.gov).

[46] *Id.* at 100-104 (describing final rule 610(c)).

[47] *Id.* at 110 (emphasis added and footnotes omitted).

In addition, we support the amendments to Rule 610 requiring that all exchange fees and rebates be determinable at the time of execution.[48] In explaining the basis for those amendments the final rule states:

> *Rule 610(d) will provide additional certainty, transparency and clarity to exchange fee structures, which will assist investors and other market participants in assessing their order placement.* Further, certainty about the cost of a transaction at the time of the trade will help broker-dealers make more informed order routing decisions, particularly benefitting customers that are sensitive to transaction costs at the execution venue, because broker-dealers and their customers will know with more certainty the cost of an exchange transaction at the time of the trade. *Investors will be able to obtain or request at the time of execution details about the exchange fees and rebates assessed on their orders without having to wait weeks until that pricing is determined and invoiced.*
>
> In addition, because the rule will allow market participants to know the amount of fees and rebates that are applicable to their transactions at the time of the trade, the rule will facilitate the ability of broker-dealers to pass back to their customers, if the customer requests and the customer and the broker-dealer both are able to accommodate the pass-through of fees, rebates, and other forms of remuneration in a more timely fashion. *Today, lower fees or higher rebates based on volume achieved in a current trading month can lead to routing for purposes of achieving a certain level of volume or attaining a possible tier level rather than routing solely to achieve best execution*. While tiers that are based on volume from a previous time-period may still incentivize routing by a broker-dealer to try to secure a higher rebate/lower fee tier in the following month, certainty regarding what tier applies at the time of trade will facilitate the ability of a broker-dealer to pass those fees and rebates through to their customers, if they so decide, on a more timely basis because they will be known at the time of the trade. Requiring certainty regarding the amount of the fee/rebate is an incremental step toward addressing commenters' concerns regarding the ability of exchanges and brokers to pass back the actual fee or report on each transaction.
>
> If market participants pass through in their entirety the exchange fees/rebates to their customers, an ancillary benefit of the new rule will be that the potential inducement to brokerdealers to route orders based on garnering the highest rebate/paying the lowest fee will be reduced since a broker-dealer would no longer retain for itself the transaction pricing benefit from its routing decision. *The new rule also will facilitate a customer's ability to obtain more timely information about what exchange transaction pricing the broker-dealer receives, which may increase accountability of the broker-dealer to the customer in ways that could lead to better order execution and more transparency regarding the fees/rebates applicable to a particular order*.[49]

[48] *Id.* at 156-157 (describing final rule 610(d)).
[49] *Id.* at 159-161 (emphasis added and footnotes omitted).

Proxy Process Amendments

As indicated, we are disappointed that the Commission's project on "Proxy Process Amendments" continues to remain categorized under "Long-Term Actions" on the Agenda.[50] We believe the SEC should prioritize the following next steps to improve proxy plumbing: (1) adding to the Agenda rulemaking that proposes technological solutions that would facilitate the tracing or attribution of individual shares to a registration statement in connection with a direct listing, a special purpose acquisition company, or a traditional IPO as previously discussed in **1. Investor Rights and Protections**; and (2) addressing end-to-end vote confirmation.[51]

End-to-End Vote Confirmation

In December 2021, a working group co-chaired by the Society for Corporate Governance and CII agreed to provide vote confirmation for 2022 annual shareholder meetings of Fortune 500 companies (Working Group). Participants included banks, broker-dealers, public companies, tabulators, transfer agents and others in the proxy service community. Broadridge Financial Solutions (Broadridge), Computershare, EQ and Mediant also agreed to provide vote confirmation for all annual meetings for which they tabulate votes, bringing the total covered to more than 2,000 meetings. While well-intentioned, the mechanism they collaborated on proved cumbersome and time-consuming.

This past proxy season, it is our understanding that automated vote confirmations were made available to institutional investors voting at many but not all U.S. companies. Leading proxy advisory firms Glass Lewis and ISS provided clients confirmation on their voting platforms that their votes were counted for U.S. companies where Broadridge acts as the tabulator. We, however, continue to believe that the current vote confirmation mechanisms fall far short of our membership approved policies which provide that the "proxy voting system should provide for end-to-end confirmation enabling both companies and shareowners to confirm that votes properly cast were included in the final tally as directed."[52] As two prominent examples, the

[50] Agency Rule List – Spring 2024, Securities and Exchange Commission, Off. Info. & Reg. Aff., Off. Mgmt. & Budget.

[51] *See* Commissioner Allison Herren Lee, Statement, Protecting the Independence of the Proxy Voting Process: Statement on Amendments Governing Proxy Voting Advice (July 13, 2022), https://www.sec.gov/news/statement/lee-statement-amendments-governing-proxy-voting-advice-071322 ("We know . . . that many shareholders are unable to confirm their shares are voted in accordance with their instructions, a concern that could be addressed through required end-to-end vote confirmations"); John Coates & Robert Pozen, FA Center, Opinion; New SEC Chair Needs to Tackle These Big Issues so the Government Can Do a Better Job for Investors, Mkt. Watch (Dec. 17, 2020), https://www.marketwatch.com/story/new-sec-chair-needs-to-tackle-these-5-big-issues-so-the-government-can-do-a-better-job-for-investors-2020-12-17 (opining that in recent years the Securities and Exchange Commission could have mandated "end-to-end vote confirmation that could improve proxy 'plumbing,' [but instead] the SEC set out examples of how proxy advisors could be sued"); *see also* Cydney Posner, Blog: Coates named Acting Director of Corp Fin, Cooley PubCo, JDSUPRA (Feb. 3, 2021), https://www.jdsupra.com/legalnews/blog-coates-named-acting-director-of-9232130/ (providing background on John Coates and the proxy plumbing issue, including end-to-end vote confirmation).

[52] CII, Policies on Other Issues, Effective and Efficient Proxy Voting (updated Oct. 28, 2018), https://www.cii.org/policies_other_issues#effective_proxy_voting.

current mechanisms fail to provide for the "reporting and auditing the votes of registered shareholders and providing end-to-end vote confirmation in proxy contests."[53]

We plan to continue to engage with the Working Group to increase Broadridge and other participants' performance standards and improve end-to-end vote confirmation. We, however, believe that concurrent with that effort the Commission should consider issuing a proposal requiring end-to-end vote confirmations to end-users, potentially with a phase-in approach starting with the largest companies. As one potential example, the proposed rule could simply require, as former SEC Commissioner Allison Herren Lee has suggested, "all participants in the voting chain to grant to issuers, or their transfer agents or vote tabulators, access to certain information relating to voting records, for the limited purpose of enabling a shareholder or securities intermediary to confirm how a particular shareholder's shares were voted."[54] We believe proposing such a rule, combined with the proposed rulemaking requiring technological solutions to facilitate the tracing of individual shares to a registration statement would go a long ways to providing the type of end-to-end vote confirmation long requested by our members and reflected in our membership approved policy.

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Thank you for your consideration of CII's views. If we can answer any questions or provide additional information on the Agenda or this letter, please do not hesitate to contact me.

Sincerely,

Jeffrey P. Mahoney
General Counsel

[53] Paul Washington, Avoiding Hanging Chads in Corporate Voting in 2024, Harv. L. Sch. On Corp. Governance (Mar. 18, 2024), https://corpgov.law.harvard.edu/2024/03/18/avoiding-hanging-chads-in-corporate-voting-in-2024/.
[54] Commissioner Allison Herren Lee, Statement, Protecting the Independence of the Proxy Voting Process: Statement on Amendments Governing Proxy Voting Advice n.6.; *cf.* Commissioner Allison Herren Lee, Speech at the 2021 ICI Mutual Funds and Investment Management Conference: Every Vote Counts: The Importance of Fund Voting and Disclosure (Mar. 17, 2022), https://www.sec.gov/news/speech/lee-every-vote-counts ("Commenters have suggested tackling this issue in a variety of ways, such as requiring intermediaries, including transfer agents, to transmit the necessary information to confirm votes, while others have suggested that we explore use of a permissioned blockchain to record beneficial ownership and execute votes.").