

State of Connecticut

DENISE L. NAPIER
TREASURER



Hartford

October 19, 2016

The Honorable Richard Blumenthal
706 Hart Senate Office Building
Washington, DC 20510

Re: H.R. 5311, Corporate Governance Reform and Transparency Act of 2016

Dear Senator ^{Back} Blumenthal,

As Treasurer of the State of Connecticut and as principal fiduciary of its \$30 billion Connecticut Retirement Plans and Trust Funds ("CRPTF"), I am writing to share my deep reservations concerning H.R. 5311, the *Corporate Governance Reform and Transparency Act of 2016*. This measure, as approved by the House Financial Services Committee on June 16, would, on its face, appear to simply require proxy advisory firms to register with the Securities and Exchange Commission ("SEC") and provide a framework for companies to review and comment on the reports issued by such firms before their release.

There are, however, troubling consequences for shareholders such as the CRPTF were this measure to pass, which is why I joined the opposition efforts of 29 members of the Council of Institutional Investors (CII), a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding \$3 trillion. Our September 6th letter, attached herewith, describes in detail the specific provisions of H.R. 5311 that are particularly problematic.

We – and most institutional investors such as public pension funds – employ proxy advisory firms to provide independent analysis of proxy voting issues. This analysis has been invaluable, which is why I am appealing to you personally and directly. H.R. 5311 threatens to undermine the integrity and independence of the process used by proxy advisory firms to develop the analysis upon which we rely in the course of exercising our proxy voting rights. As such, if H.R. 5311 comes to a vote on the floor of the House or in any committee on which you serve, I urge you to oppose it.

My concerns are informed by Connecticut's long history as a shareholder advocate for corporate governance reforms, and the certainty that the effectiveness of our advocacy is directly correlated to the independent, unfettered analysis provided by the firms this bill

would regulate. By way of background, the annual voting of thousands of proxies for the myriad of companies in which Connecticut's plans and trusts are invested is considered part and parcel of fiduciary duty. Indeed, these proxy voting rights are deemed plan assets because the process for shareholder participation in the governance of the companies that we own is an essential element of long-term shareholder value. As the principal fiduciary of the CRPTF, I take this responsibility very seriously because it is a proven mechanism for ensuring the performance of our investments.

Connecticut has scored several significant victories through the shareholder advocacy process -- victories that have evolved into corporate governance best practices that have inured to the benefit of all investors. For example, the CRPTF was the first public fund to file a shareholder resolution on climate change at American Electric Power in 2002, and after several years of discussions with them, AEP became the first company to agree to issue a comprehensive report to shareholders disclosing potential liabilities posed by climate change. Other companies have since followed that lead, and the link between climate change and long-term shareholder value is now widely accepted.

As hard as it may be to believe today, when I became State Treasurer in 1999 there was no requirement for corporate board member independence. There were boards with a majority of non-independent members, and key board committees (e.g., governance and nominations, compensation, and audit) had non-independent members. Now, due to shareholder advocacy, all corporate boards of public companies are required to have a majority of independent board members, and all key committee members must be independent of management.

Beyond these specific governance issues, there are thousands of votes at the annual meetings of public companies which fall within three general categories: (1) election of members of the board of directors; (2) resolutions proposed by management, as required by the company's bylaws or by federal statute; and (3) resolutions proposed by shareholders. Most, if not all, public funds lack the staff resources necessary to analyze each resolution, which is why many depend on proxy advisory services for analysis. In Connecticut's case, all votes are cast on our behalf in accordance with established proxy voting policies, as proposed by me, as Treasurer, and adopted by the State's independent Investment Advisory Council. For shareholders that do not have their own guidelines, proxy advisory firms' policies govern, and they are based on the input and direction of their investor clients.

The Honorable Richard Blumenthal
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While some of these votes are routine, many are not, which is why the added support of independent analysis is so critical to our proxy voting activities. H.R. 5311 would undermine this independence by mandating a review of a firm's analysis by the management of the very companies that may be scrutinized. This is a classic example of the fox guarding the henhouse. Simply put, it is bad legislation which will compromise the stewardship of our investments.

For all of these reasons, I urge you to vote against H.R. 5311, as well as any comparable effort to amend similar language to another bill.

If you have any questions or wish to discuss this further, please feel free to call on me, or my Assistant Treasurer for Policy, Mary Phil Guinan at [mp.guinan@ct.gov](mailto:mp.guinan@ct.gov) (860-702-3163).

Sincerely,



Denise L. Nappier  
State Treasurer

*Best Regards!*

Attachment

Via Hand Delivery

September 6, 2016

The Honorable Richard C. Shelby  
Chairman  
Committee on Banking, Housing, and Urban Affairs  
United States Senate  
Washington, DC 20510

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

*Re: Proposed Legislation Relating to Proxy Advisory Firms*

Dear Mr. Chairman and Ranking Member Brown:

I am writing on behalf of the Council of Institutional Investors (CII), a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding \$3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than \$20 trillion in assets under management.<sup>1</sup> This letter has been co-signed by 30 CII members and other organizations.

We are writing to share our concerns about proposed legislation currently under consideration in the U.S. House of Representatives regarding proxy advisory firms. H.R. 5311, the Corporate Governance Reform and Transparency Act of 2016,<sup>2</sup> aims to tighten regulation of proxy advisory firms to the detriment of pension funds and other institutional investors.

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<sup>1</sup> For more information about the Council of Institutional Investors (Council or CII) and our members, please visit the Council's website at [http://www.cii.org/about\\_us](http://www.cii.org/about_us). We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), are non-voting associate members of CII, paying an aggregate of \$24,000 in annual dues—less than 1.0 percent of CII's membership revenues. In addition, CII is a client of ISS, paying approximately \$19,600 annually to ISS for its proxy research.

<sup>2</sup> On June 16, 2016, the Committee on Financial Services of the United States House of Representatives approved H.R. 5311, as amended, by a vote of 41 to 18. All Actions, Congress.Gov, *available at* <https://www.congress.gov/bill/114th-congress/house-bill/5311/all-actions?q=%7B%22search%22%3A%5B%22H.R.+5311%22%5D%7D&resultIndex=1&overview=closed#tabs>. On June 23, 2016, Committee on Financial Services Chairman Jeb Hensarling issued a Discussion Draft of a bill that included the provisions of H.R. 5311. Financial CHOICE Act of 2016, §§ 1081-83, *available at* [http://financialservices.house.gov/uploadedfiles/choice\\_act\\_discussion\\_draft.pdf](http://financialservices.house.gov/uploadedfiles/choice_act_discussion_draft.pdf).

The proposed legislation appears to be based on the false premise that proxy advisory firms dictate proxy voting results. Many pension funds and other institutional investors contract with proxy advisory firms to obtain and review their research. But most large holders vote according to their own guidelines.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to “say on pay” proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against these proposals at 12 percent of Russell 3000 companies in 2016, only 1.7 percent of those proposals received less than majority support from shareowners.<sup>3</sup> Similarly, although ISS opposed the election of 6.5 percent of director-nominees during the most recent proxy season, just 0.2 percent failed to obtain majority support.<sup>4</sup> We are unaware of any compelling empirical evidence indicating that pension funds and other institutional investors are outsourcing their voting responsibilities to proxy advisory firms.

We believe the proposed legislation would weaken corporate governance in the United States; undercut proxy advisory firms’ ability to uphold their fiduciary obligation to their investor clients; and reorient any surviving firms to serve companies rather than investors. The U.S. system of corporate governance relies on the accountability of boards of directors to shareowners, and proxy voting is a critical means by which shareowners hold boards to account.

Proxy advisory firms, while imperfect, play an important and useful role in enabling effective and cost-efficient independent research, analysis and informed proxy voting advice. In our view, the proposed legislation would undermine proxy advisory firms’ ability to provide a valuable service to pension funds and other institutional investors.

We are particularly concerned that, if enacted, H.R. 5311 would:

- **Require that proxy advisory firms (1) provide companies advance copies of their recommendations and most elements of the research informing their reports, (2) give companies an opportunity to review and lobby the firms to change their recommendations, and (3) establish a heavy-handed “ombudsman” construct to address issues that companies raise.**

This right of pre-review would give companies substantial influence over proxy advisory firms’ reports, potentially undermining the objectivity of the firms’ recommendations. On a practical level, this right of review would delay pension funds and other institutional investor’s receipt of the reports and recommendations for which they have paid.

The requirement that the proxy advisory firms resolve company complaints prior to the voting on the matter would create an incentive for companies subject to criticism to delay

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<sup>3</sup> Semler Brossy, 2016 Say on Pay Results 2-3 (July 27, 2016), available at <http://www.semlebrossy.com/wp-content/uploads/SBCG-2016-SOP-Report-07-27-2016.pdf>.

<sup>4</sup> ISS Voting Analytics Database (last viewed on Aug. 4, 2016 & on file with CII).

publication of reports as long as possible. Pension funds and other institutional investors would have less time to analyze the reports and recommendations in the context of their own customized proxy voting guidelines to arrive at informed voting decisions. Time already is tight, particularly in the highly concentrated spring “proxy season,” due to the limited period between company publication of the annual meeting proxy statement and annual meeting dates.

Moreover, the proposed legislation does not appear to contemplate a parallel requirement that dissidents in a proxy fight, or proponents of shareowner proposals, also receive the recommendations and research in advance. This would violate an underlying tenet of U.S. corporate governance that where matters are contested in corporate elections, management and dissident shareowners should operate on an even playing field.

- **Require the Securities and Exchange Commission (SEC) to assess the adequacy of proxy advisory firms’ “financial and managerial resources.”**

The entities that are in the best position to make these types of assessments are the pension funds and other institutional investors that choose to purchase and use the proxy advisory firms’ reports and recommendations. In 2014, the SEC staff issued guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents.<sup>5</sup> We publicly supported that guidance.<sup>6</sup> We are unaware of any compelling empirical evidence indicating that the guidance is not being followed or that the burdensome federal regulatory scheme contemplated by the proposed legislation is needed.

- **Create costs for institutional investors with no clear benefits.**

The proposed legislation would appear to result in higher costs for pension plans and other institutional investors – potentially much higher costs if investors seek to maintain current levels of scrutiny and due diligence around proxy voting. Moreover, the proposed legislation is highly likely to limit competition, by reducing the current number of proxy advisory firms in the U.S. market and imposing serious barriers to entry for potential new firms. This would also drive up costs to investors. Given these economic impacts, we are troubled that there appears to be no cost estimate on the provisions of this proposed legislation.<sup>7</sup>

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<sup>5</sup> Staff Legal Bulletin No. 20 at 3 (June 13, 2014) (“it is the staff’s position that an investment adviser that receives voting recommendations from a proxy advisory firm should ascertain that the proxy advisory firm has the capacity and competency to adequately analyze proxy issues, which includes the ability to make voting recommendations based on materially accurate information”), available at <https://www.sec.gov/interps/legal/cfs1b20.htm>.

<sup>6</sup> Letter from Jeff Mahoney, General Counsel, CII, to The Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services et al. 4 (July 23, 2014), available at <https://www.sec.gov/interps/legal/cfs1b20.htm>.

<sup>7</sup> It does not appear that the Congressional Budget Office has produced a cost estimate for H.R. 5311. CBO Cost Estimates Search (last viewed Sept. 6, 2016), available at, [https://www.cbo.gov/cost-estimates/search?search\\_api\\_views\\_fulltext=H.R.+5311&field\\_congressional\\_session=1621](https://www.cbo.gov/cost-estimates/search?search_api_views_fulltext=H.R.+5311&field_congressional_session=1621).

Thank you for considering these views. We would be very happy to discuss our perspective in more detail. I am available at [ken@cii.org](mailto:ken@cii.org), or by telephone at (202) 822-0800. You may also contact our General Counsel Jeff Mahoney at [jeff@cii.org](mailto:jeff@cii.org), or by telephone at the same number.

Sincerely,



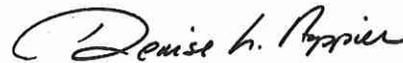
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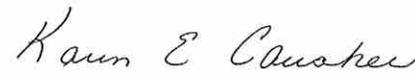
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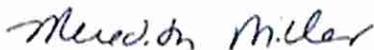
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TIAA



Meredith Miller  
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UAW Retiree Medical Benefits Trust



Keiran Quinn  
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UK Local Authority Pension Fund Forum



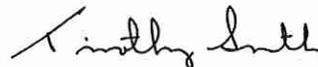
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Theresa Whitmarsh  
Executive Director  
Washington State Investment Board

CC: The Honorable Michael D. Crapo, Chairman, Subcommittee on Securities, Insurance, and Investment, Committee on Banking, Housing, and Urban Affairs

The Honorable Mark Warner, Ranking Member, Subcommittee on Securities, Insurance and Investment, Committee on Banking, Housing, and Urban Affairs  
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