CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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November 9, 2015

Mr. Gary Retelny
President and Chief Executive Officer
Institutional Shareholder Services
702 King Farm Boulevard
Suite 400
Rockville, MD 20850

Re: **2016 Benchmark Policy Consultation**

Dear Mr. Retelny:

The U.S. Chamber of Commerce[1] ("Chamber") created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century global economy. We are writing to comment on the Institutional Shareholder Services' ("ISS") 2016 Benchmark Policy Consultation (the "Consultation"). Our comments are directed to the Consultation Policies stated to be applicable solely to U.S.-based companies: (1) board actions without shareholder approval, (2) director service on more than one board, and (3) compensation practices and disclosure by externally-managed issuers.

We renew the concern that we have expressed in the past that the period of ten business days that ISS has provided to comment on the Consultation and for final policies to be issued nine days after, is simply unreasonable and not the hallmark of a deliberative open-minded approach.[2] Indeed, this is unheard of with standard setters and we have stated that ISS tends to be considered as such in the corporate governance world.[3] The CCMC continues to believe that this must call into question the reliability of any policies that result from the Consultation process. ISS has also failed to provide commenters how these policies will impact the economic return of investors. Our specific comments on the policies are stated below.

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[1] The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.
[2] *See*, *e.g.*, our letter to ISS dated October 28, 2014, available at http://www.issgovernance.com/file/policy/US_Chamber_of_Commerce.pdf.
[3] The consultation period closes on November 9 and the final polices will be released on November 18th.

Board Actions without Shareholder Approval

For many years, the CCMC has called for broad based reform, as the current level of regulatory overlap and confusion have made the U.S. capital markets inefficient and placed American businesses at a competitive disadvantage to others around the world. This has increasingly served to discourage private companies from entering the US public markets through an initial public offering.[4] Conversely, the CCMC has also championed efforts, such as the Jumpstart Our Business Startups Act ("JOBS Act"), which are intended to facilitate private and public capital formation in the United States. The JOBS Act enjoyed broad bipartisan support in both chambers of Congress and President Obama enthusiastically signed it into law in 2012.

It should come as no surprise then, that the CCMC opposes any proposed ISS policy that would serve to penalize directors of newly-public companies. Founders of public companies enact lawful defensive measures for the simple reason that they would prefer to innovate and grow the business rather than focus on defending against opportunistic tactics of shareholder activists or hostile bidders. Congress, in creating the category of Emerging Growth Companies in the JOBS Act, seems to hold a similar viewpoint. Moreover, in an initial public offering, the terms of a staggered board or supermajority voting requirements are fully disclosed to shareholders at the time of their investment decision. It is not clear why directors should be penalized once, let alone at successive meetings, if investors choose to purchase shares knowing these terms. Were ISS to implement policy changes of the kind discussed in the Consultation, we believe many privately-held emerging growth companies would be discouraged from entering the US public markets.

Beyond the chilling effect on innovation that comes with artificially closing capital markets, a stagnant or declining pool of investment choices is detrimental to American investors. Simply put, investors do not benefit by having fewer public

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[4] *See*, *e.g.*, *U.S. Capital Markets Competitiveness: The Unfinished Agenda* (Summer 2011), *available at* http://www.centerforcapitalmarkets.com/u-s-capital-markets-competitiveness-the-unfinished-agenda/; *Restoring Confidence in the U.S. Capital Markets: A Call for Financial Services Regulatory Modernization* (Mar. 11, 2009), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/14689_Declaration_08.pdf; *Report of the Commission on the Regulation of U.S. Capital Markets in the 21st Century* (Mar. 2007), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/06/Commission-on-the-regulation-of-us-cap-markets-report-and-recommendations.pdf.

companies in which to invest. We strongly urge ISS to table any proposed policy changes that seek to penalize newly public companies and their directors.

Similarly, the CCMC also opposes the Consultation's proposed changes in respect of seasoned issuers. Boards are already constrained in their ability to act by their fiduciary duties under state law. These duties require the directors to determine the best interests of the corporation and its stockholders, including in response to an unsolicited takeover proposal. We do not believe that ISS should adopt a guideline that could be inconsistent with the prevailing standards under state corporation law.

Director Service on More than One Board

The CCMC generally rejects one-size-fits-all corporate governance initiatives. Under the appropriate mechanisms provided under state and federal law, management, directors, and shareholders should decide the governance structures best suited for a business—this issue is no different. We are also concerned about the disruptive effect on boards that would accompany an increase in the number of resignations by directors seeking to conform to a sudden change in ISS policy.

The number of boards on which a given director can ably serve is a highly subjective determination dependent on a number of variables, including among other things a company's particular industry, the relative complexity of its business model, its geographic footprint, the length and frequency of board and committee meetings, and the individual skills and competencies of the director. ISS's preferred use of the pejorative term "overboarding" reveals its bias on the matter and implies that a single magic number is divinable. And ISS has presented no empirical evidence demonstrating that service on multiple boards makes directors less effective. Directors who have the unique perspective of sitting on other boards may, in fact, be better suited to exercise their fiduciary duties and effectively oversee company management.

ISS's own survey results on the issue reveal no clear consensus as to an optimal number, and for good reason—none exists. Instead of arbitrarily selecting a number that neither considers the specifics of the company nor the abilities of the director, we believe ISS and the investor-clients to whom it owes fiduciary duties would be better served by devoting more resources and attention to the individual facts and circumstances of a particular company and its individual directors. The objective of the Consultation should not be to create a simple metric that easily lends itself to automated analysis and exacerbates the problem of check-the-box governance.

Setting artificial limits on the number of boards on which any individual director may serve will have the effect of depriving investors of some highly-qualified directors. For example, when it comes to certain highly-specialized areas (such as cybersecurity, financial regulation, international operations, or biotechnology), the pool of directors with knowledge and prior experience is not limitless. It stands to reason that directors with credentials in these or other high-demand areas will be asked to serve on multiple boards. Whether any director has the wherewithal to contribute to several boards is a highly contextual question, and it is by no means a foregone conclusion that a talented director cannot make a significant contribution to multiple boards if he or she makes the effort to do so. Conversely, setting any arbitrary limits will unnecessarily limit the pool of effective director candidates and create the potential that other boards will be forced to consider less ideal candidates.

While chief executive officers ("CEOs") certainly have a greater primary commitment to the companies they lead, we also oppose caps on the number of boards on which CEOs may serve. We similarly see no reason to deprive investors of the knowledge and viewpoint a sitting CEO can bring to other public company boards. And board service can also make a CEO a better leader of his or her own company based on the far-ranging experiences and expanded professional network he or she may gain while serving on other boards.

The CCMC thus rejects any effort to set a default number of boards on which a particular director can or should serve. Instead, we urge ISS to do the work its investor-clients expect of it by considering each company and each director individually in light of the demands placed on them by board service at multiple companies. It should not be overly burdensome for ISS to make a case-by-case assessment of company performance, develop a view on a director's board commitments, and consider the number of meetings the director attends at other public companies because this information is readily available in each company's proxy statement. To be sure, such a customized analysis is likely to reveal that some directors should focus their attention on fewer boards. But, by the same token, other directors will excel while serving multiple boards. ISS should not place its thumb on this scale through the adoption of an indefensible policy.

Compensation Disclosure by Externally-Managed Issuers

The Consultation, if adopted, would be unduly burdensome to externally-managed issuers ("EMIs") with no appreciable benefits to their stockholders. EMIs typically engage a third-party manager to provide services and expertise pursuant to a management contract for a fee. The manager is usually an asset management firm that provides management services to multiple clients. The manager remains subject to the oversight of the EMI's board. Under the management contract, the manager typically provides executive officers to the EMI with ultimate discretion as to the terms of employment of such individuals (including compensation) left to the manager.

The EMI has no control over how the manager compensates its employees and oftentimes has no information on their compensation. These managers are usually private entities that are not subject to the disclosure requirements of the Securities and Exchange Commission ("SEC"). The employees of the manager that serve as executive officers of the EMI typically also perform services for the manager's other clients, with no specific allocation of their total compensation for services performed to each client.

To the extent that the EMI does pay compensation to an employee of the manager for his or her services to the EMI or specifically reimburses the manager for a portion of the employee's compensation in addition to the management fees paid to the manager, the EMI provides disclosure about this compensation in its proxy statement pursuant to SEC rules. As a result, stockholders of an EMI already receive complete information about the fees and compensation that the EMI pays for the third-party management services provided by the manager and its employees without the proposal described in the Consultation. Moreover, analyzing the total compensation paid to the external manager is an entirely appropriate and meaningful way to evaluate the overall pay-for-performance of the EMI. These disclosures enable stockholders to evaluate whether the fee arrangements included in the management agreement create incentives in the best interests of stockholders and are reasonable in relation to the nature and quality of services performed by the manager.

The existing disclosure readily permits boards and stockholders to evaluate the management fee and the EMI's performance compared to its peers and other entities.

The Consultation would require disclosure by EMIs of information regarding the compensation paid by third-party private companies to their employees, and the EMIs potentially would be liable for that information, even though it is outside their ability to control. In addition, an EMI may not be able to compel its manager to disclose such information, which would theoretically result in an "against" vote on the say-on-pay vote under the Consultation. Even if an EMI did provide this disclosure, it would not provide helpful information to stockholders, because the EMI would not have the ability to change the compensation paid by the manager to its personnel and would still be required to pay the contractual management fee. Furthermore, as stated earlier, the compensation paid by the manager to its employees who serve as officers of the EMI may include compensation for services performed by such employees for other clients of the manager which have nothing to do with the EMI. Finally, to the extent that the manager is not performing satisfactory services or the board of the EMI determines that the management fee is not fair, the board typically can terminate the management agreement with the manager—often subject to paying a termination fee unless the agreement is terminated for cause (as defined in such agreement)—or renegotiate the management fee.

The SEC recognizes the practical and other limitations on providing compensation information for EMIs and therefore does not require disclosure of the type contemplated in the Consultation under its disclosure and reporting rules. Adopting the proposal in the Consultation:

(i) would not provide additional detail on the amount of compensation paid by the EMI,

(ii) could create liability for EMIs for information provided by third-party managers,

(iii) could result in an "against" vote recommendation on a say-on-pay vote if an EMI cannot force a third-party manager to provide information on the compensation of its employees,

(iv) could expose the third-party manager to potential exposure for disclosing information in the EMI's proxy statement although the manager is not subject to the SEC's disclosure obligations,

(v) would create unnecessary and burdensome record-keeping and compensation allocation for third-party managers with the board of the EMI having no ability to direct or change the compensation of the manager's employees, and

(vi) could make it more difficult to attract directors to serve on the board of an EMI.

Furthermore, the CCMC notes that the survey cited by the Consultation stated that only a single investor raised conflicts of interest concerns with respect to compensation arrangements of EMI structures. ISS utilizes this single investor's concern to overlay a disclosure regime developed for internally managed companies on EMIs, which is ill-suited for reasons discussed above. CCMC also notes that boards of directors of public companies routinely follow well established processes to address potential conflicts of interests concerns. Finally, ISS should consider whether the proposal is a solution in search of a problem given that, in 2015, the vast majority of EMIs received overwhelming positive approval in their say-on-pay votes without disclosure of the type that ISS contemplates in the Consultation.

In sum, the CCMC urges ISS not to adopt any changes on this topic.

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We thank you for your consideration of these comments and would be happy to discuss these issues further with you or your staff.

Sincerely,

Tom Quaadman