November 30, 2005

Alan Beller
Director, Division of Corporation Finance
US Securities and Exchange Commission
100 F. Street
Washington, D.C. 20549

Re: **Executive Compensation Disclosure**

Dear Mr Beller:

These comments are submitted in contemplation of an impending SEC rulemaking proposal regarding enhanced disclosures on executive compensation. They reflect discussions between investors, consultants, directors and academics in which the undersigned participated at the International Roundtable on Executive Remuneration held in Los Angeles on September 28, 2005.

The signatories to this letter are ten institutional investors from the United States, Canada and Europe. In the aggregate, we manage nearly one trillion dollars, much of which is invested in the United States.

Given the importance of the subject matter and the fundamental change in direction of the disclosure scheme that we believe is necessary, we thought it would be appropriate to submit this letter for your consideration prior to release of an SEC proposal. The basis for our concern is illustrated by the following:

- Corporate assets used to compensate the top five executives at companies grew from less than five percent to more than ten percent of aggregate corporate earnings between 1993 and 2003, resulting in a substantial diminution in company and portfolio values with no associated strengthening of management incentives;[1]
- Boards often fail to bargain at arms' length when setting executive pay, and compensation has become broadly disconnected from long-term performance;[2]
- Sixty companies in the bottom decile of the Russell 3000 lost $769 billion in market value and $475 billion in economic value over the five years ended in 2004, while paying their top five executive officers more than $12 billion;[3]

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[1] Bebchuk and Grinstein, "The Growth of Executive Pay," Harvard Law and Economics Discussion Paper No. 510 (April 2005). Total compensation paid to the top five executives added up to more than $250 billion during the 1993 to 2003 time period.

[2] Bebchuk and Fried, "Pay without Performance: The Unfulfilled Promise of Executive Compensation," Harvard University Press (2004). Current compensation arrangements dilute executives' incentives to serve shareholder interests and can create perverse incentives to destroy rather than create long-term value.

[3] Van Clieaf and Kelly, "Myths of Executive Compensation: Returning to Basic Principles of Pay for Performance," The Corporate Governance Advisor (September/October 2005). Updated data from the study reported in that article is contained in the spreadsheet submitted with this letter. We realize that additional information would be needed to determine whether the compensation paid at a particular company reflects pay for performance, and do not infer that pay is unrelated to performance of the executives at each of the listed companies. However, the pattern within the companies cited indicates that a general disconnect between pay and performance exists.

- Executive compensation is cited by institutional investors as the most important corporate governance issue they face today.[4]

While shareholders must look to directors, particularly compensation committee members, to re-establish pay for performance, executive compensation disclosures today (with few exceptions) are woefully inadequate to allow shareholders to evaluate their directors and determine how the company is using compensation to motivate its most senior managers.[5] We believe executive compensation decisions are a good indication of the level of independence and business judgment exercised by directors. Better disclosure is needed to help us evaluate risk to our capital and potential return when making investments, as well as to help us make proxy voting decisions.

It should be emphasized that the type of executive compensation transparency we recommend is already mandated for British and Dutch companies.[6] For example, boards at UK companies are required to make detailed annual disclosures of executive compensation plans and payments, including:

- salaries;
- fees;
- bonuses;
- expense allowances;
- non-cash benefits;
- option awards;
- long-term incentive plans;
- pay for performance award criteria;
- pension and retirement benefits;
- termination payment provisions;
- companies used for comparisons;
- the relative importance of performance-based factors;
- identity of any consultant and details of other services they have provided; and
- amendments to incentive or option plans.

These UK (and similar Dutch) requirements include forward-looking information. Financial aspects of the compensation disclosures in the UK are reviewed by the external auditors.

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[4] "Survey finds executive comp key issue for institutional investors," Pensions & Investments, April 4, 2005, page 2. The survey was conducted by Pensions & Investments and Vivient Consulting LLC. The top three issues were executive compensation (34%), director accountability (15%) and financial reporting (13%).

[5] See Attachment 1 for an example of how the current disclosures make it difficult for shareholders to evaluate an executive compensation plan and determine how closely an executive's compensation is related to his/her performance.

[6] The British disclosure requirements for listed companies are contained in sections 234B and 241A and schedule 7A of the Companies Act of 1985 and came into force on August 1, 2002. They also require that the remuneration report be submitted to the shareholders at the annual meeting for an advisory vote. The Dutch disclosure and shareholder approval requirements, in effect since 2004, are similar in most respects and are contained in the Dutch Corporate Governance Code and sections 135, 383c, 383d and 383e of the Dutch Civil Code. Dutch executive remuneration policies are subject to approval at each company's annual general meeting of shareholders.

The British and Dutch signatories to this letter have experienced improvement in the quality of dialogue and understanding of executive compensation issues between directors and shareholders under the UK and Dutch disclosure systems. We believe our recommendations would produce similar benefits in the US.

Recommendations

We suggest that the SEC consider the following disclosure requirements when developing its rulemaking proposal.

Disclosures should start from a principles-based approach and be aggregated in one place: Information on pay and performance should be easily obtained from the proxy statement itself, and shareholders should not require extensive outside research and analysis to develop an opinion. Too often, proxy statements contain boilerplate statements that sound good but convey little actual information. To avoid obfuscation, disclosure mandates should require compliance with the spirit as well as the letter of the law.

- Disclosure principles should ensure that investors receive a transparent and plain English description of:
    - The compensation plan's approach to pay for performance;
    - Determination of competitive compensation levels for each named executive;
    - Long- and short-term incentive compensation plan metrics, targets and measurement periods;
    - Total cumulative compensation, including all significant consideration, regardless of when or how it could be paid or provided;
    - Responsibilities of the compensation committee, board, management and consultants in developing and implementing the plan; and
    - How compensation of executives fits within the company's overall compensation practices for senior employees.

- In order to avoid continuing the dilemma we currently face, we suggest that a principles-based disclosure regime include a mechanism that provides a fast and efficient enforcement mechanism for shareholders to obtain full disclosure when it is not provided.

- Should accurate forward-looking compensation disclosures be accorded some level of protection from federal securities law liability in order to encourage full disclosure?

Disclosures should include total compensation: We believe that the value of all compensation and benefits – including retirement benefits – should be monetized and disclosed annually. Both absolute and year over year information should be presented.

- We suggest the following be considered as disclosure requirements:
    - Annual fixed cash compensation (including salary and dividends on restricted stock);
    - Annual bonuses, profit sharing and other cash payments;
    - Annual option and other performance-based equity awards;

- The value of compensation for multi-year incentive programs (i.e., under long-term incentive plans) which is paid, awarded, earned or vested in that year, such as options granted and the market value of restricted stock;

- The targets, time periods and measurement metrics for bonuses and incentive compensation, as well as any changes made during the year and who measures the performance;

- The value of retirement benefits earned (perhaps assuming the executive retired at normal retirement age and also assuming the executive left immediately), including any post-retirement benefits or perks awarded;

- All other compensation and consideration, including perks, retention, termination, change in control and transaction-related compensation.[7]

Cumulative compensation should be shown: We also believe the cumulative effect of a company's compensation decisions should be disclosed. For example, the proxy statement could include a table showing the cumulative compensation earned by each of the named executive officers over the past five years, including the amount received as a result of option exercises and the value of unexercised and unvested options. Both absolute numbers and year over year comparisons should be presented.

- The value of equity compensation capable of being earned should be shown under various scenarios, such as at threshold, target and maximum levels of performance for all programs in effect (even long-term plans covering a multi-year period where the proxy statement covers only the first year of the period).

- Any hedge, swap or other transfer of compensation economic value should be disclosed.

- The context in which the compensation has been awarded should be presented. For example, the company's return on invested capital, total shareholder return, market value added (or subtracted) and/or economic profit (or loss) for the previous five year period could also be included.

  - Disclosure of the percentage of operating profit represented by executive compensation (e.g., for each of the preceding five years) would assist shareholders in performing a pay for performance analysis;

  - Shareholders would be able to use this information to dialogue with companies about the appropriate amount of sharing between investors and management; and

  - If description of performance metrics in compensation plans presents the potential for manipulation of results due to variations in the assumptions or calculation methods used, specific provisions should be established to protect investors from misleading or unreasonable calculation methodologies in data used to make pay for performance compensation disclosures.

[7] In order to deal with variation in how companies interpret perquisites for purposes of required disclosure, the SEC may need to establish a clear and broad definition for reporting of "perks" and cover how they are to be valued. We also believe that current disclosure materiality thresholds should be substantially lowered.

Pay for performance information should be fully disclosed: Investors deserve honest and clear disclosure of the measures and time periods being used to determine managerial success for each named executive and how those measures link to the firm's business strategy and long-term success. In order to fulfill their fiduciary responsibilities, shareholders must be able to see what executives are being held accountable to, and paid to, accomplish on both a forward-looking and retrospective basis. We believe that consideration should also be given to the following specific requirements:

- Disclosure of the company's cost of capital in the compensation report so that investors can readily tell when a company has actually earned a true economic profit;

- Disclosure of the specific forward-looking measures set for executives, if it can be done without hampering the company's competitive position. Even if the specific business targets are not disclosed, investors should be provided sufficient information to understand the metrics, targets and measurement periods being used;[8]

- Companies that use more than one performance metric should be required to disclose the proportional weighting of each one;

- Measures should be broken down into time frames, so that investors can clearly tell what the one-year goals and the three-year and longer goals are - and the difference between the two. Identification of which measures are current operational measures and which are long-term strategic measures[9] would help shareholders determine whether the company is focused on sustainable performance;

- If long-term goals are disclosed, a definition of "long term" should be established (e.g., three years or longer) to avoid confusion over operational and strategic goals and show what levels of compensation are tied to both types of goals?

- Disclosures should include both financial and extra-financial (e.g., customer satisfaction, employee turnover, ethics compliance, environmental harm) measures being used to guide management behavior and evaluate their performance;

- Disclosure of what the CEO and each named executive is being held accountable for that is in addition to or different from the accountability standards for his/her direct reports would help shareholders evaluate the company's compensation planning process;

- The measures being applied to each individual executive officer role should be required in order to facilitate investor assessment of the efficiency of a company's compensation plan and organizational structure; and

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[8] For example, companies may be able to retroactively describe performance measures without specifically identifying the targets and do so without compromising their competitive position.

[9] A review of 2004 proxy statements by The Corporate Library concluded that 85 percent of companies have no stated multi-year performance targets to encourage executives to create long-term value, despite more than half of a company's enterprise value being based on expectations of future growth and innovation. Van Clieaf and Kelly, "The New DNA of Corporate Governance: Strategic Pay for Future Value," The Corporate Governance Advisor (May/June 2005).

- Pay that can be accelerated by meeting performance targets, but that will be paid at some point regardless of performance, should be identified as "performance-accelerated," rather than "performance-based?"

Comparables relevant to evaluation of the compensation plan should be disclosed: Disclosure of the companies, measurement time periods and positions comprising the peer group being used for compensation purposes should be mandated.[10] If that group does not comprise the same companies used as competitive peers in the five-year total shareholder return chart, the performance of the compensation peer group should be disclosed.

- The Compensation Committee should be required to explain how it selected the compensation peer companies and comparator positions, including how it accounted for differences in the performance of the companies selected and for differences in the executive roles[11] between the peer group and its own company's executive roles; and

- Consideration should be given to requiring disclosure of compensation information for the two levels of management below the CEO to provide a means for shareholders to evaluate internal fairness (i.e., internal pay equity) of the compensation plan. Shareholders could also use internal pay equity as an indicator of organizational culture and the board's independence from the CEO.

The Compensation Committee's narrative should be more meaningful: Investors deserve to know how the Compensation Committee decided to award the compensation it did in light of performance of the company and the individual executive. We believe the Compensation Committee should describe the pay philosophy it is applying in its compensation programs for senior executives and should be required to explain how each element of the company's compensation programs relates to that philosophy. It should also explain how the forward-looking and retrospective long-term measures it chose relate to the company's strategic plans.

In particular, we believe consideration should also be given to the following disclosure requirements:

- If a company pays performance-based compensation for years in which the company has not even earned its cost of capital, the Compensation Committee should be required to clearly explain why;

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[10] A review of 100 company proxies by the consulting firm Equilar found that only 2 percent provided the names of peer group companies used in setting executive compensation. Boston.com, March 29, 2005, "Benchmarking Inflates CEO's Salaries," Associated Press, visited November 21, 2005 (http://www.boston.com/business/personalfinance/articles/2005/03/29).

[11] Executives' roles can vary substantially between comparable companies. To illustrate, consider Johnson & Johnson, which is a compensation peer company for Eli Lilly. The 2003 cash compensation of Johnson & Johnson's CEO was $ 3.2 million, while Eli Lilly's was $ 2.1 million. On the surface it would appear that Eli Lilly's CEO was underpaid. However, it might be that the Johnson & Johnson CEO role has been determined to be more complex and difficult – so the uncalibrated compensation numbers provide a misleading statement of the amount of compensation the Eli Lilly CEO is receiving, which may be appropriate *on a comparable basis*.

- The Committee should explain how the compensation plan's long-term measures are different from the short-term measures it is using, so that shareholders can understand whether the company is paying executives twice for the same accomplishments;

- To assist investors in determining whether a company's executives have a disincentive to seek payment of dividends, the Compensation Committee should be required to disclose whether the option and equity components of the compensation plan are dividend neutral (i.e., awards are adjusted for dividends);

- If compensation was awarded that was not earned according to the plan metrics, the Compensation Committee should be required to disclose why;

- Whether the Compensation Committee has reviewed existing plan metrics, targets and performance periods for adjustment or for changing circumstances should be disclosed, including whether any adjustments were made and why;

- To identify potential conflicts of interest, whether any compensation consultant retained by the Compensation Committee has received compensation for providing other services to, or has otherwise been retained by, the company should be disclosed;

- Disclosures should include whether or not the company's executives' contracts contain (and describe) clawback or similar provisions to recover compensation improperly paid on the basis of performance criteria that are subsequently restated or revised; and

- Change in control provisions embedded in executive contracts or elsewhere, should be identified along with an explanation of how they benefit shareholders.

In summary, we believe that the current US executive compensation disclosure requirements have serious deficiencies that limit the ability of investors to evaluate the structure and operation of executive compensation plans. Improved disclosure around pay for performance concepts would help to strengthen corporate governance and better position companies to succeed over the long term in the increasingly competitive world markets.

We thank you for this opportunity to have input into the executive compensation disclosure rule making process. If we can be of any help in further expanding on these recommendations, feel free to contact us.

Very truly yours,

Mark Anson
Chief Investment Officer
California Public Employees Retirement System

Christopher J. Ailman
Chief Investment Officer
California State Teachers' Retirement System

Ian Jones
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Roderick Munsters
Chief Investment Officer
Stichting Pensioenfonds ABP (Netherlands)

Clive Edwards
Deputy Chief Investment Officer
Universities Superannuation Scheme Ltd (UK)

Attachments: (Example of Limitations in Current Disclosure Regimen)

(Matrix Investment Research – Honeywell Report)

(MVC Associates International Pay for Performance Analysis)

cc: Paula Dubberly, Associate Director, Division of Corporation Finance

Betsy Murphy, Chief, Office of Rulemaking, Division of Corporation Finance

David Lynn, Chief Counsel, Division of Corporation Finance