13 February 2009

The Honorable Barack Obama **(via Facsimile & Federal Express Delivery)**
President of the United States
The White House
1600 Pennsylvania Avenue NW
Washington, DC 20500

The Honorable Nancy Pelosi **(via Email & Federal Express Delivery)**
Speaker of the House
United States House of Representatives
235 Cannon House Office Building
Washington, DC 20515-0508

The Honorable Harry Reid **(via Facsimile & Federal Express Delivery)**
Senate Majority Leader
522 Hart Senate Office Building
Washington, DC 20510

Re: **United States Financial Market and Corporate Governance Reforms**

Dear Mr. President, Madam Speaker and Senator Reid:

At the request of 28 global institutional investors with more than $1.3 trillion of assets under management, which represents the investment and pension savings of 15 million individuals, I am pleased to submit their attached letter. The investors write to seek your leadership toward adoption of critical legal reforms to the United States financial markets and corporate governance practices.

Please contact me, or any of the signatories, if you have questions or would like further assistance on these issues.

Very truly yours,

Meagan Thompson-Mann
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Burbank, CA 91505
(818) 748-7660
meagant@gmail.com

cc: Senator Christopher Dodd, Chair
Senate Committee on Banking, Housing and Urban Affairs

Congressman Barney Frank, Chair
House Committee on Financial Services

Mary Schapiro, Chair
Securities & Exchange Commission

Senator Jack Reed, Chair
Senate Subcommittee on Securities, Insurance and Investment

Representative John Boehner
House Republican Leader

Senator Mitch McConnell
Senate Minority Leader

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Re: **United States Financial Market and Corporate Governance Reforms**

Dear Mr. President, Madam Speaker and Senator Reid:

We write as global investment managers with more than $1.3 trillion of assets under management, representing the savings and pension assets of 15 million individuals, to express our strong support for critical legal reforms to the United States financial markets and corporate governance practices.

Mr. President, in your inaugural address you highlighted the need for change in the financial markets, "The state of the economy calls for action, bold and swift, and we will act - not only to create new jobs, but to lay a new foundation for growth." We wholeheartedly agree. The time to restore investor trust in the integrity of America's capital markets and public corporations is long overdue.

We believe that fundamental reforms are needed to build the foundation of which you spoke. In particular, we see the United States markets as desperately needing:

- Collaborative development of best corporate governance practices, with a flexible 'comply or explain' company reporting approach; and
- Enactment of reforms described in the attached December 2, 2008 letter to Speaker Pelosi from the Council of Institutional Investors, namely:
    - Shareowner access to the proxy;
    - A majority vote standard for election of corporate directors;
    - Transition to independent board leadership with a split chair/CEO;

- An advisory shareholder vote on executive compensation;
- Repeal of the authority for brokers to vote uninstructed shares;
- Stronger provisions for clawing back illicitly-paid executive compensation;
- Limits on the use of conflicted executive compensation consultants; and
- Restrictions on executive severance payments that reward poor performance.

Over the last decade, foreign ownership of United States corporate securities has more than tripled.[1] Although many of the undersigned investors are located outside of the United States, we have collectively invested billions of dollars in United States companies. Accordingly, we have a keen interest in both the integrity and success of the United States market.

As global investors, we also recognize that practices in the United States and other major markets influence each other. Because practices in other markets have been improving, investors have begun to re-evaluate the relative investment risks presented by corporate governance practices in the United States.[2] To remain competitive in this environment, we believe the United States must promptly embrace the reforms we identified above and which are further discussed below.

*Executive compensation practices*
Executive pay at United States companies has too often been unrelated to company performance. As each of you has observed, executive compensation in the United States has reached outlandishly unnecessary levels compared to every other world market. Yet, despite these extravagant compensation practices, United States companies have not effectively managed risk exposures or produced outsized returns for shareholders.

From Congressional hearings held in 2007, we are aware that executive compensation plans at United States companies are often developed by consultants that have conflicts of interest due to lucrative contracts awarded them by the same executives covered by the plans.[3] Far too often, we have seen executives receive huge severance and change-in-control payments that effectively function as a reward for their prior poor performance. Improperly-paid incentive compensation based on fraudulently manipulated results has rarely been recovered, even though clawback provisions could be used to avoid illicit windfalls. These practices have undermined investor confidence in the market and should be prohibited where they have not been approved by a vote of shareholders.

*Shareholder advisory vote on executive compensation*
In many other developed markets, shareholders and directors regularly interact on issues relating to executive compensation. This communication often occurs in the context of shareholder votes on company pay practices. For example, Britain implemented advisory

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[1] Congressional Research Service Report for Congress, *Foreign Ownership of US Financial Assets: Implications of a Withdrawal,* January 14, 2008.
[2] For example, Governance Metrics International currently rates Ireland, Canada, Britain and Australia above the United States in quality of corporate governance.
[3] House Committee on Oversight and Government Reform, *Executive Pay: Conflicts of Interest Among Compensation Consultants,* December 2007.

votes in 2003. They have been credited there with moderating the rate of increase in executive compensation, dramatically increasing the use of incentive pay and reducing executive pay levels at companies with negative operating performance.[4] Both companies and shareholders have seen this vote process as beneficial.[5]

Some countries, including the Netherlands, use binding shareholder votes, where general principles underlying compensation plans must be approved by shareholders. However, shareholder votes on executive compensation are advisory in most other markets. We see adoption of such an advisory shareholder vote as a critical first step toward addressing the executive compensation problems that permeate the United States market.

*Independent Board Chair Separate from the CEO*

Board leadership is another area where the United States is falling behind. Appointment of an independent board chair is the predominant practice in Britain, Europe and Canada. However, barely more than one in five United States companies in the S&P 500 has an independent board chair.[6] Even the National Association of Corporate Directors recently issued a report which emphasizes the importance of independent board leadership and says that boards without an independent chair should explain why they have adopted such an approach.[7]

We see the absence of a strong, independent chair as a structural impediment to effective board oversight of management and a factor that presents increased risk to shareholders. A split CEO/Chair structure for independent board leadership should be made standard practice at public companies in the United States.

*Shareholder Access to the Proxy*

Many shareholders view the United States director election process as being amongst the most undemocratic in the developed markets. Company owners rarely have the right to call a shareholder meeting to remove ineffective directors, and they have no practical way of putting forth director candidates at uncooperative companies without mounting an expensive proxy fight.

We all invest in markets that allow shareholders to remove ineffective directors and/or more easily put candidates up for election at the annual meeting. Our experience in Britain, Australia and the Netherlands, for example, is that boards whose members may be removed and replaced by shareholders are more attuned to investor opinion and much more likely to engage in meaningful dialogue with their shareholders. Moreover, we have found that availability of these rights has not proved to be disruptive to companies

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[4] Keith L. Johnson and Daniel Summerfield, *Shareholder Say on Pay,* International Corporate Governance, November 2008.

[5] Stephen Davis and Stephen Alogna, *Policy Briefing No. 2: Talking Governance, Board-Shareowner Communications on Executive Compensation,* The Millstein Center for Corporate Governance and Performance, Yale School of Management (2008).

[6] RiskMetrics Group, *Board Practices: Trends in Board Structure at S&P 1,500 Companies,* December 17, 2008.

[7] National Association of Corporate Directors, *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies,* October 2008.

or encouraged election contests. Instead, boards in those markets are incentivized to put forth higher quality independent director candidates that will be approved by shareholders. We believe that companies in the United States would benefit from creation of shareholder rights to place board candidates on the proxy.

*Majority Vote Standard for Election of Directors*

We applaud the recent movement in the United States toward adoption of a majority shareholder vote requirement for election of director candidates. However, the majority vote process that has been adopted by most companies still allows boards to override a shareholder vote and keep the rejected director in place.[8]

Our experience in other developed markets that use a true majority vote standard for election of corporate directors, including Britain, the Netherlands, Australia, New Zealand, Germany and France, has been positive. We find that it encourages better communications between shareholders and directors and strengthens alignment of interests between the board and company owners. The majority vote standard should be applied to all United States public companies.

*Broker votes*

Shares that are not voted in advance of an annual meeting typically end up being voted by brokers (who hold them in brokerage accounts) in favor of the company director slate. This amounts to legalized ballot stuffing and has changed the vote results in a number of elections. For example, uninstructed broker votes changed the outcome of director elections at the Washington Mutual 2008 annual meeting and the 2007 CVS annual meeting.

Since 2006, the NYSE has twice proposed abolishing the ability of brokers to vote uninstructed shares in director elections, but the SEC has failed to approve the change. It is time for the SEC to take action.

*Corporate governance best practices*

Finally, we believe the United States market would benefit from an interactive process involving companies, investors, regulators and other stakeholders (such as accounting, compensation design, proxy voting and consumer representatives) to develop and regularly review corporate governance best practices. When combined with a comprehensive disclosure regime using a 'comply or explain' approach similar to what is already in place in many other developed markets, this would encourage improved governance practices and promote ongoing communication between companies and their owners about best practices, while ensuring that individual companies retain the flexibility to adopt practices that meet their needs.

For example, a 'comply or explain' approach might identify annual board member elections as a best practice. Boards that decided to depart from that practice would be

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[8] For example, three directors at Axcelis Technologies received more than 57 percent votes against their election at the 2008 shareholder meeting, but the board refused to accept their resignations. RiskMetrics, *Postseason Review: Withheld Votes,* October 17, 2008.

obligated to provide an explanation in the annual report to shareholders. Similarly, standards for disclosure of material extra-financial factors (such as the business ramifications of a company's carbon emissions, reputation risks, product obsolescence, etc.) might also be addressed through a 'comply or explain' process.[9] Of course, effectiveness of this approach would require adoption of the other reforms outlined in this letter to ensure an appropriate balance between management, the board and shareholders.

We would like to see this process led in the United States by an appropriate government entity, with a goal for implementation of a best practices 'comply or explain' disclosure requirement in 2010. Other markets, including Britain, the Netherlands and Australia, have gone through similar processes and might be evaluated as models. We would be happy to assist with that process and believe that participation from outside of the United States would help to ensure broad support by investors that provide the necessary capital to United States companies.

We look forward to working with you in the near future on these important issues and hope you will contact any of us if we can be of further assistance.

Very truly yours,

Lochiel Crafter

Lochiel Crafter
Chief Executive Officer
ARIA - Australia

Vidette Bullock Mixon

Vidette Bullock Mixon
Director Corporate Relations
General Board of Pension and Health Benefits – The Methodist Church - US

A Skipper

Anita Skipper
Corporate Governance Director
Aviva Investors - UK

Lance E. Lindblom
President and Chief Executive Office
The Nathan Cummings Foundation - US

[9] For additional information on extra-financial disclosure, see the International Corporate Governance Network Statement and Guidance on Non-Financial Business Reporting at the following website address: http://www.icgn.org/news/releases/ICGN_Statement_NFBR.pdf. . Additional information about developing a comply or explain reporting approach to corporate governance best practices is available from the International Finance Corporation Global Corporate Governance Forum website at: http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/PSO10/$FILE/GCGF+PSO+issue+10+12-8-08.pdf.

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Attachment: Council of Institutional Investors Letter to Speaker Pelosi

cc: Senator Christopher Dodd, Chair
Senate Committee on Banking, Housing and Urban Affairs

Congressman Barney Frank, Chair
House Committee on Financial Services

Mary Schapiro, Chair
Securities & Exchange Commission

Senator Jack Reed, Chair
Senate Subcommittee on Securities, Insurance and Investment

Representative John Boehner
House Republican Leader

Senator Mitch McConnell
Senate Minority Leader

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# COUNCIL OF INSTITUTIONAL INVESTORS

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December 2, 2008

The Honorable Nancy Pelosi
Speaker of the House
235 Cannon House Office Building
Washington, DC 20515

Re: Financial Markets Regulatory Reform Legislation

Dear Madam Speaker:

On behalf of the Council of Institutional Investors and the undersigned member funds, I am writing to urge you to consider a number of key corporate governance improvements for inclusion in any financial markets regulatory reform legislation that may be pursued by the 111th Congress.

The Council is a nonprofit association of public, union and corporate pension funds with combined assets that exceed $3 trillion. Member funds are major long-term shareowners with a duty to protect the retirement assets of millions of American workers. The Council strives to educate its members and the public about good corporate governance, shareowner rights and related investment issues, and to advocate on our members' behalf.

As significant long-term investors, Council member funds have a deep, abiding interest in ensuring that the capital markets are on a sound footing. The global financial crisis has unmasked weaknesses in US regulation of the capital markets and has badly shaken trust in those markets. Simply put, the current crisis represents a massive failure of oversight. In order to restore trust and ensure that such a crisis never happens again, regulators and investors must be given the tools necessary to guarantee robust oversight and meaningful accountability of corporate managers and directors.

As Congress evaluates potential reforms, certain principles should be paramount: Oversight must include an independent and reliable regulator with a mandate of investor protection; and required disclosures of the issuers of securities must be robust, timely and meaningful. Above all, investor protection and enforcement of the rules must be vigorous.

Vigorous regulation focusing on investor protection cannot alone solve many of the issues that led to the current crisis, however. While crucial, such regulatory oversight is no replacement for shareowner driven market discipline. Only through the combination of effective regulation and strong investor oversight will trust be restored and future crises avoided. Investors need stronger tools to hold managers and boards accountable.

In our view, a number of key corporate governance reforms are essential to providing meaningful investor oversight of management and boards. Such measures would address many of the problems that led to the current crisis, and more importantly, empower shareowners to anticipate and address unforeseen future risks. Governance reforms must thus be part of any broader legislative effort to improve the effectiveness of the regulation of our financial markets.

More specifically, the governance improvements that the Council believes would have the greatest impact and, therefore, should be contained in any financial markets regulatory reform legislation include:

1. **Majority Voting for Directors:** Directors in uncontested elections should be elected by a majority of the votes cast.

2. **Shareowner Access to the Proxy:** A long-term investor or group of long-term investors should have access to management proxy materials to nominate directors.

3. **Broker Voting Restrictions:** Broker non-votes and abstentions should be counted only for purposes of a quorum.

4. **Independent Board Chair:** The board should be chaired by an independent director.

5. **Independent Compensation Advisers:** Compensation advisers and their firms should be independent of the client company, its executives and directors, and should report solely to the compensation committee.

6. **Advisory Shareowner Vote on Executive Pay:** All companies should provide annually for advisory shareowner votes on the compensation of senior executives.

7. **Stronger Clawback Provisions:** At a minimum, senior executives should be required to return unearned bonus and incentive payments that were awarded due to fraudulent activity or incorrectly stated financial results.

8. **Severance Pay Limitations:** Executives should not be entitled to severance payments in the event of termination for poor performance.

We look forward to working with you on this critical issue of reforming the regulation of the financial markets. To continue the dialogue, we plan on contacting your office in the near future to arrange for a mutually convenient date and time to meet with you and your staff in person to share views and discuss these matters in more detail. In the meantime, if you have any questions, please feel free to contact me at (202) 261-7081 or jeff@cii.org, or Council analyst Jonathan Urick at (202) 261-7096 or jonathan@cii.org.

Sincerely,

Jeff Mahoney

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