United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510-6250

November 18, 2010

VIA EMAIL (Rule-Comments@sec.gov)

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: Shareholder Approval of Executive and Golden Parachute Compensation, and Disclosure of Related Proxy Votes; File Nos. S7-30-10 and S7-31-10

Dear Ms. Murphy:

The purpose of this letter is to express support for the proposed rules issued by the Securities and Exchange Commission (SEC) to authorize shareholder approval of executive compensation and golden parachute compensation, and require disclosure of related proxy votes. The proposed rules would also benefit from several strengthening measures as indicated below.

Subcommittee Investigations. The U.S. Senate Permanent Subcommittee on Investigations, which I chair, has conducted several investigations relevant to executive pay issues.

In 2002, the Subcommittee conducted an inquiry into the Enron scandal, including issues related to the Board of Directors' oversight of executive pay. The Subcommittee found that the Board had "failed to safeguard Enron shareholders," including by allowing Enron to engage in "excessive executive compensation." The Subcommittee also found that the Board had "failed to monitor the cumulative cash drain" caused by Enron's 2000 executive compensation plans, and "failed to monitor or halt abuse" by Enron's Board Chairman and Chief Executive Officer (CEO) Kenneth Lay of a company-financed line of credit. The Subcommittee report showed how, in addition to providing Mr. Lay with $140 million in 2000, the Board's Compensation Committee gave him access to a $4 million line of credit, later increased to $7.5 million, and allowed him to repay any extensions of credit with cash or company stock. In a one-year period from October 2000 to October 2001, Mr. Lay used that credit line to obtain over $77 million in cash from the company and repaid the loans with Enron stock obtained from exercising stock options granted to him as part of his compensation. The Subcommittee determined that Mr. Lay withdrew the cash from the company coffers at a time when Enron was experiencing cash flow shortages, Enron's shares were dropping, and Enron shareholders were suffering losses. After Enron's collapse, it was discovered that Mr. Lay had borrowed a total of $81 million from the company in 2001, and failed to repay about $7 million. When asked about these matters at a hearing, the head of Enron's Compensation Committee said that his committee had no duty to monitor the CEO's loan activity and declined to criticize Mr. Lay's conduct.

In 2007, the Subcommittee conducted an investigation and held a hearing on inconsistent accounting and tax requirements for executive stock option compensation. The hearing examined nine case histories of U.S. companies that used stock options to compensate their executives. Data from the nine companies showed that, altogether, the amount of stock option tax deductions they claimed from 2002 through 2006, was about five times greater than the expenses they would have reported to the SEC if tough new accounting rules had been in effect when the options were granted. Those nine companies reported about $1.2 billion in total tax deductions for CEO stock options compared to a projected total of $217 million in stock option expenses on their books. That is a difference of about $1 billion between the tax deductions taken and the expenses that would have been booked at these nine companies. IRS data at the hearing showed that, overall in 2005, U.S. companies claimed $43 billion more in stock option tax deductions than the stock option expenses on their books. IRS data in later years showed companies claimed $61 billion in "excess" stock option tax deductions in 2006; another $48 billion in 2007; and another $52 billion in 2008. These enormous excess tax deductions, which are applicable solely to stock options, help illustrate the scope of one type of executive pay and help explain how executive compensation has contributed to a pay gap in which CEOs at large companies now receive an average of $7 million, about 400 times the pay of average workers.

Over the last two years, the Subcommittee has also conducted an extensive investigation and held a series of hearings delving into key causes of the financial crisis. Those hearings have touched, in part, on executive pay issues. Our first hearing, for example, which featured Washington Mutual Bank (WaMu) as a case study, focused on that bank's origination, acquisition, and securitization of high-risk mortgages. The investigation determined that WaMu's CEO, Kerry Killinger, received over $103 million in compensation from 2003, the year the bank began to pursue a high risk lending strategy, through 2008, the year the bank collapsed because of that strategy. In 2008, Mr. Killinger was asked to leave the bank, yet received over $25 million in compensation that year, including a $15 million severance payment. A later hearing focused on the credit rating agencies Moody's and Standard and Poor's which issued top credit ratings for thousands of residential mortgage backed securities (RMBS) and collateralized debt obligation (CDO) securities, and later issued mass downgrades of those ratings, sparking the collapse of the RMBS and CDO markets. In 2007, Moody's CEO, Raymond McDaniel, received $8.8 million and stock options worth more than $2.3 million. Another hearing focused on the role of investment banks in the financial crisis, using Goldman Sachs as a case study. Goldman Sachs and other investment banks played a crucial part in building and running the conveyor belt that fed toxic RMBS and CDO securities into the financial system. In 2007, each of the top five executives at Goldman Sachs received between $49 million and $70 million.[1]

Excessive executive compensation is an ongoing outrage. In 2009, with the nation still reeling from the worst financial crisis since the Great Depression, the very financial institutions whose irresponsible risk taking caused the crisis reportedly awarded $145 billion in bonuses to their executives and employees.[2] J.P.Morgan Chase, which received $25 billion in taxpayer dollars from the Troubled Asset Relief Program, paid its CEO $15 million in 2009, while Goldman Sachs, which received $10 billion in TARP taxpayer dollars, paid its CEO $8 million.[3]

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[1] See Goldman Sachs Group, Inc., 2007 Summary Compensation Table, included in 2008 Schedule 14A Proxy Statement filed with the SEC.

[2] "Banks Set for Record Pay," The Wall Street Journal, Jan. 14, 2010.

[3] See The Wall Street Journal Survey of CEO Compensation, Nov. 15, 2010.

Complaints have also been made that the compensation paid to financial executives too often rewards high risk strategies and short term profits over prudent risk management. And in too many cases, financial executives walk away from troubled institutions with millions of dollars in their pockets, while shareholders and taxpayers are left shouldering losses.

The Dodd-Frank Act. The purpose of the Dodd-Frank Act is to "promote the financial stability of the United States by improving accountability and transparency in the financial system." In the area of executive pay, Congress determined that accountability and transparency begin with communications between directors and shareholders. By granting shareholders broad rights to provide advisory opinions on executive compensation and golden parachute plans at the companies they own, the Dodd-Frank Act seeks to instill a culture of accountability in the executive pay arena. Likewise, by requiring institutional investment managers to file annual public reports identifying their proxy votes on executive pay and golden parachute issues, the statute seeks to hold them accountable for their voting decisions.

The proposed rules raise a host of issues; this letter concentrates on the following.

Shareholder Approval of Executive Compensation. The proposed rules faithfully implement Section 951 of the Dodd-Frank Act requiring shareholder approval of executive compensation and golden parachute plans. The proposed rules will, for example, enable shareholders to provide an advisory opinion on the compensation packages offered to the corporation's top five executives, and allow shareholders to vote on whether they want to approve those compensation packages every 1, 2, or 3 years.

The rules also propose to amend Item 402(b)(1) of Regulation S-K, to include in the already mandatory discussion and analysis of executive pay issues, a discussion of how the issuer responded to shareholder votes on executive compensation or golden parachute issues. Requiring issuers to acknowledge the outcome of the shareholder votes and disclose how they responded to them is critical to carrying out the intent of the Dodd-Frank Act to give shareholders a voice on compensation issues at the companies they own. Without this mandatory discussion, issuers could simply ignore the shareholder votes, and shareholders would be unable to compel disclosure of how the issuer responded to the votes. By mandating not only the discussion, but that the discussions be included in a public filing, the proposed rules will help ensure that issuers provide an accurate and complete description of how they responded to shareholder sentiment.

Shareholder Approval of Golden Parachute Arrangements. The proposed rules requiring disclosure of golden parachute arrangements and a separate shareholder vote on those arrangements as part of any shareholder agreement to a merger, acquisition, or similar corporate event also faithfully implement the statute's provisions. The proposed table for disclosing the golden parachute compensation to be paid in the event of a merger, acquisition, or similar event, is particularly useful to ensure that this information is disclosed in a clear, organized, and consistent fashion. The explicit requirement that the table include an aggregate total amount of the compensation to be paid to a particular executive accurately implements the statute. Use of this table will help shareholders understand the compensation being provided, conduct comparisons with other companies, and make informed decisions on whether to approve a proposed arrangement.

Comment was requested on whether the information in the table should be limited to the five executives whose compensation is otherwise disclosed in issuer materials. Given that many more than five executives may be compensated in the event of a merger or acquisition, the better approach would be to require the table to identify every executive who is expected to receive substantial additional compensation and provide the required information for each named executive. Only by including all executives expected to receive substantial additional compensation – which could be defined as the receipt of $1 million or more – will the table provide shareholders with meaningful disclosure regarding the amount of corporate funds to be distributed to management in connection with a merger, acquisition, or similar event.

Comment was also requested on whether the table should include, for each of the identified executives, information about vested equity, stock option, and pension benefits and the total amount of compensation from these forms of compensation that would be available to the executive in the event of the merger, acquisition, or similar event. This information, as well as information on any deferred compensation, should be added to the table to ensure shareholders understand the compensation already available to executives and help them evaluate the merits of the additional compensation being contemplated.

Comment was also requested on whether the Golden Parachute Compensation Table should be required only when an extraordinary corporation transaction has been proposed, in all annual proxy statements, or in any proxy statement containing a proposal for shareholders to vote on a compensation matter. The problem with presenting golden parachute information for the first time in connection with a proposed merger or acquisition is that any analysis of the compensation issues will likely be secondary to other issues related to the larger event. Presenting the information earlier, especially in the context of proxy statements addressing other compensation issues for shareholders, would help ensure a more dispassionate and informed analysis of the compensation being proposed.

Treatment of Smaller Companies. The proposed rules take the right approach in deciding not to exempt any class of small publicly traded corporations from the Dodd-Frank requirements. The proposed rules correctly conclude that shareholders of smaller companies have the same interests in ensuring reasonable executive compensation and golden parachutes as shareholders at larger companies. Given that the employees of small companies are often also company shareholders, their financial interest seems at least as strong, if not more so, than shareholders in large corporations, to ensure that compensation incentives are not designed to favor imprudent, high risk actions or expend excessive company resources on a small number of senior executives.

Institutional Investment Manager Reporting. It is estimated that nearly 50% of Americans own stock, either personally or through various funds. Because most U.S. shareholders exercise their votes through a proxy rather than directly, the Dodd-Frank Act included provisions to ensure that shareholders can find out how their shares were voted. Empowering shareholders to track and analyze the votes cast by investment managers, using publicly available information, will enable them to determine whether the manager they use is voting in accordance with their wishes and, if not, which manager might be a better choice. The proposed rule requiring institutional investment managers to file public reports of their proxy

votes on executive compensation and golden parachute matters faithfully carries out the statute's provisions.

The proposal to apply the proxy disclosure requirements to "any security" is fully in line with the broad disclosure requirements in the statute. The decision not to exempt any class of securities from the proxy vote disclosure requirement is reasonable, since any exemption would impose a greater hardship on shareholders holding the exempted securities, might impose additional costs on managers to determine which votes should be disclosed and which should not, and might also create an unwarranted incentive for financial firms to favor the issuance of the exempt securities. The decision against specifying a threshold below which a manager would not be required to report its votes is also reasonable, since it would be unfair to deny investors access to voting information solely because their manager does not hold a specified number of shares.

The proposed amendments specifying what proxy voting information must be disclosed in what order in Form N-PX are not only reasonable, but critical to ensuring that the information is provided in a clear, organized, and consistent manner. Requiring disclosure, for example, of the number of shares the reporting person was entitled to vote, the number of shares the person actually voted, how the person voted those shares, and whether the vote was for or against a management recommendation, will allow investors to monitor, understand, and hold their proxies accountable for their votes. Requiring the data to be displayed in a consistent manner will assist analysis of multiple votes. The requirement to specify how the proxy vote compared to the company management recommendation is particularly useful to enable analysts, regulators, and policymakers to track and understand voting patterns.

Voting Instructions. Section 957 of the Dodd-Frank Act essentially prohibits brokers with discretionary voting authority from voting shares on executive compensation matters without first receiving shareholder instructions. This prohibition was needed to stop brokers from voting for corporate pay proposals to curry favor with corporate executives. The proposed rule should consider, however, whether to allow brokers and other institutional investment managers to offer shareholders the option of establishing standing voting instructions to cast their ballots in a certain way on executive pay matters, provided that the managers also permit shareholders to override the standing instructions at will. Shareholders could then leave instructions, for example, to vote against certain types of executive pay or to vote in line with company management on executive pay matters, unless otherwise instructed. The availability of standing instructions might make it easier for retail shareholders to exercise their voting authority.

Proxy Solicitation Rules. One issue that is not addressed in the proposed rules is proxy solicitation restrictions. Current proxy solicitation rules severely curtail communications among shareholders. The proposed rules might be strengthened by easing the restrictions when it comes to votes on executive pay or golden parachute matters in order to foster shareholder dialogue, shared analysis of compensation issues, and informed decisionmaking.

Confidentiality. The proposed rules indicate that the Commission intends to make Form N-PX containing proxy voting information a public document, absent special circumstances. This approach is in line with the fundamental character of the securities laws, which value transparency and public disclosure. At times, some commentators have taken up a different confidentiality issue -- advocating provisions that would enable shareholders to avoid providing their names and contact information to issuers on the ground that shareholder privacy must be protected. U.S. securities laws have never been designed, however, to favor secrecy over transparency, and publicly traded corporations were not constructed to hide the identities of their owners; just the opposite. In fact, the United States is a world leader in advocating greater transparency for corporate beneficial ownership information as a means to combat financial crime, money laundering, tax evasion, and other misconduct. To prevent corporate misuse of shareholder information, a better approach would be for the proposed rules to prohibit issuers from selling or transferring shareholder contact information to any affiliate or outside party except as required to carry out the purposes of the securities laws.

Thank you for this opportunity to comment on the proposed rules.

Sincerely,

Carl Levin
Chairman
Permanent Subcommittee on Investigations